1985

Uniform CPA examination. Questions and unofficial answers, 1985 November

American Institute of Certified Public Accountants. Board of Examiners

Uniform CPA Examination

November 1985

Questions and Unofficial Answers

AICPA

American Institute of Certified Public Accountants

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A Supplement to the Journal of Accountancy

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FOREWORD

The Uniform CPA Examination is prepared by the Board of Examiners of the American Institute of Certified Public Accountants and is used by the examining boards of all fifty states of the United States, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands as a prerequisite for issuance of CPA certificates. This booklet contains the questions and unofficial answers of the November 1985 Uniform Certified Public Accountant Examination.

Although the questions and unofficial answers may be used for many purposes, the principal reason for their publication is to aid candidates in preparing for the examination. Candidates are also encouraged to read *Information for CPA Candidates,* which describes the content, grading, and other administrative aspects of the Uniform CPA Examination.

The unofficial answers were prepared by the staff of the examinations division and reviewed by the Board of Examiners but are not purported to be official positions of the American Institute of Certified Public Accountants. Each of the unofficial answers is accompanied by its maximum point value assigned by the Board of Examiners for grading purposes.

William C. Bruschi, *Vice President — Regulation*
American Institute of Certified Public Accountants

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EXAMINATION IN ACCOUNTING PRACTICE — PART I

November 6, 1985; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, the objective answer sheet is page 1 and your other pages should be numbered 2 through 12.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the objective answer sheet before the examination time is up.

3. Support **all** problem-type answers with properly labeled and legible calculations that can be identified as sources of amounts in formal schedules, entries, worksheets, or other answers, to show how your final answer was derived. Computation sheets should identify the question to which they relate, be placed immediately following the answer to that question, and be numbered in sequence with the other pages. Failure to enclose supporting calculations may result in loss of grading points because it may be impossible to determine how your amounts were computed.

4. For Question Number 5 be sure to include the completed tear-out worksheet in the proper sequence with other answer sheets.

5. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to \$5,260,000; sales returns and allowances reduced the amounts owed by \$160,000. How much were net sales last year for Baker Company?

a \$4,800,000
b \$5,100,000
c. \$5,200,000
d. \$5,260,000

Answer Sheet

97. ⓐ ● ⓒ ⓓ

Items to be Answered

1. Day, Inc., began business on January 1, 1984, and at December 31, 1984, Day had the following investment portfolios of marketable equity securities:

	In current assets	*In noncurrent assets*
Aggregate cost	\$150,000	\$225,000
Aggregate market value	120,000	185,000
Net unrealized loss	\$ 30,000	\$ 40,000

None of the declines is judged to be other than temporary. Valuation allowances at December 31, 1984, should be established with corresponding charges against

	Income	*Stockholders' equity*
a.	\$70,000	\$0
b.	\$40,000	\$30,000
c.	\$30,000	\$40,000
d.	\$0	\$70,000

2. On December 31, 1984, West Company had the following cash balances:

Cash in banks	\$1,800,000
Petty cash funds (all funds were reimbursed on 12/31/84)	50,000

Cash in banks includes \$600,000 of compensating balances against short-term borrowing arrangements at December 31, 1984. The compensating balances are not legally restricted as to withdrawal by West. In the current assets section of West's December 31, 1984, balance sheet, what total amount should be reported as cash?

a. \$1,200,000
b. \$1,250,000
c. \$1,800,000
d. \$1,850,000

3. At the end of its first year of operations, December 31, 1984, Mill Company had accounts receivable of \$600,000, net of the related allowance for doubtful accounts. During 1984 Mill recorded charges to bad debt expense of \$90,000 and wrote off \$20,000 of uncollectible accounts receivable. In its December 31, 1984, balance sheet, how much should Mill report as accounts receivable before the allowance for doubtful accounts?

a. \$600,000
b. \$620,000
c. \$670,000
d. \$710,000

4. Farr Company accepted a \$50,000 face value, 6-month, 10% note dated April 15, 1985, from a customer. The same date Farr discounted the note at Eagle National Bank at a 12% discount rate. How much cash should Farr receive from the bank on April 15, 1985?

a. \$48,400
b. \$49,350
c. \$49,500
d. \$52,500

5. The following information appears in Dix Company records for the year ended December 31, 1984:

Merchandise inventory, 1/1/84	\$ 275,000
Purchases	1,125,000
Sales	1,500,000

On December 31, 1984, a physical inventory revealed that the ending inventory was only \$300,000. Dix's gross profit on sales has remained constant at 30% in recent years. Dix suspects that some inventory may have been pilfered by one of the new employees. At December 31, 1984, what is the estimated cost of missing inventory?

a. \$ 25,000
b. \$ 50,000
c. \$ 75,000
d. \$100,000

6. On October 1, 1984, Yost Company purchased 400 of the $1,000 face value, 10% bonds of Pell, Inc., for $440,000, which includes accrued interest of $10,000. The bonds, which mature on January 1, 1991, pay interest semiannually on January 1 and July 1. Yost uses the straight-line method of amortization and appropriately recorded the bonds as a long-term investment. The bonds should be shown on Yost's December 31, 1984, balance sheet at
   a. $428,400
   b. $428,800
   c. $430,000
   d. $440,000

7. The following accounts were abstracted from Cox Company's unadjusted trial balance at December 31, 1984:

	Debit	*Credit*
Accounts receivable	$500,000	
Allowance for doubtful accounts	4,000	
Net credit sales		$2,000,000

Cox estimates that 3% of the gross accounts receivable will become uncollectible. After adjustment at December 31, 1984, the allowance for doubtful accounts should have a credit balance of
   a. $11,000
   b. $15,000
   c. $19,000
   d. $60,000

8. On January 1, 1984, King Company's allowance for doubtful accounts had a credit balance of $15,000. During 1984 King: (1) charged $32,000 to bad debt expense, (2) wrote off $23,000 of uncollectible accounts receivable, and (3) unexpectedly recovered $6,000 of bad debts written off in the prior year. The allowance for doubtful accounts balance at December 31, 1984, should be
   a. $47,000
   b. $32,000
   c. $30,000
   d. $24,000

9. The following information applied to Ott Company for 1984:

Merchandise purchased for resale	$600,000
Freight-in	15,000
Interest on notes payable to vendors	6,000
Purchase returns	3,000

Ott's inventoriable cost for 1984 was
   a. $600,000
   b. $603,000
   c. $612,000
   d. $618,000

10. The following information is available from the records of Bell Company for the year ended December 31, 1984:

	At cost	*At retail*
Inventory, 1/1/84	$ 360,000	$ 520,000
Purchases	1,320,000	1,840,000
Additional markups		40,000
Markdowns		160,000
Sales		1,920,000

Under the approximate lower of average cost or market retail method, Bell's inventory at December 31, 1984, is
   a. $224,000
   b. $240,000
   c. $320,000
   d. $480,000

11. Clay Company started construction of a new office building on January 1, 1984, and moved into the finished building on July 1, 1985. Of the building's $2,500,000 total cost, $2,000,000 was incurred in 1984 evenly throughout the year. Clay's incremental borrowing rate was 12% throughout 1984, and the total amount of interest incurred by Clay during 1984 was $102,000. What amount should Clay report as capitalized interest at December 31, 1984?
   a. $102,000
   b. $120,000
   c. $150,000
   d. $240,000

12. On July 1, 1985, Town Company purchased for $540,000 a warehouse building and the land on which it is located. The following data were available concerning the property:

	Current appraised value	*Seller's original cost*
Land	$200,000	$140,000
Warehouse building	300,000	280,000
	$500,000	$420,000

Town should record the land at
   a. $140,000
   b. $180,000
   c. $200,000
   d. $216,000

13. On July 1, 1985, a fire destroyed $200,000 of Lane Company's $600,000 inventory (fair market values). Lane carried a $240,000 fire insurance policy with an 80% co-insurance clause. What is the maximum amount of insurance that Lane can collect as a result of this loss?
   a. $200,000
   b. $192,000
   c. $160,000
   d. $100,000

14. Lock Company sells, for cash, appliance service contracts agreeing to service appliances for a one-year, two-year, or three-year period. Cash receipts from contracts are credited to the unearned service contract revenues account which had an unadjusted balance of $1,580,000 at December 31, 1984. Service contract costs are charged, as incurred, to the service contract expense account which had a balance of $370,000 at December 31, 1984. Outstanding service contracts at December 31, 1984, expire as follows:

During 1985 —	$450,000
During 1986 —	350,000
During 1987 —	275,000

At December 31, 1984, how much should Lock report as unearned service contract revenues?

a. $ 505,000
b. $ 705,000
c. $1,075,000
d. $1,210,000

15. On January 2, 1984, Terry Company signed a ten-year noncancelable lease for a machine, stipulating annual payments of $20,000 starting at the end of the first year, with title passing to Terry at the expiration of the lease. The machine has an estimated useful life of 12 years, with no salvage value. Terry uses straight-line depreciation for all of its fixed assets. Aggregate lease payments were determined to have a present value of $123,000, based on implicit interest of 10%. For 1984, Terry should record depreciation (amortization) of

a. $0
b. $10,250
c. $12,300
d. $20,000

16. Ames Company adopted a pension plan on January 1, 1983, on a funded, noncontributory basis. Ames elected to amortize past service cost over twelve years and to fund past service cost over ten years. Normal cost is to be funded as incurred each year. The following schedule reflects normal cost, amortization of past service cost and funding for 1983 and 1984:

	1983	*1984*
Normal cost	$ 90,000	$ 95,000
12-year amortization	100,000	100,000
Reduction for interest	—	1,155
Past service cost	100,000	98,845
10-year funding	109,628	109,628

In its December 31, 1984, balance sheet, Ames should report a deferred charge for pension cost at

a. $10,783
b. $13,845
c. $14,628
d. $20,411

17. Eliot Corporation's liabilities at December 31, 1984, were as follows:

Accounts payable & accrued interest	$200,000
12% note payable issued November 1, 1984, maturing July 1, 1985	60,000
10% debentures payable, next annual principal installment of $100,000 due February 1, 1985	700,000

On March 1, 1985, Eliot consummated a noncancelable agreement with the lender to refinance the 12% note payable on a long-term basis, on readily determinable terms that have not yet been implemented. Both parties are financially capable of honoring the agreement, and there have been no violations of any of the agreement's provisions. Eliot's December 31, 1984, financial statements were issued on March 31, 1985.

In its December 31, 1984, balance sheet, Eliot should report current liabilities at

a. $200,000
b. $260,000
c. $300,000
d. $360,000

18. Apex Company employees earn two weeks of paid vacation for each year of employment. Unused vacation time can be accumulated and carried forward to succeeding years, and will be paid at the salary in effect when the vacation is taken. As of December 31, 1984, when Paul's salary was $600 per week, Paul had earned 18 weeks vacation time and had used 12 weeks of accumulated vacation time. At December 31, 1984, how much should Apex carry as a liability for Paul's accumulated vacation time?

a. $0
b. $1,200
c. $3,600
d. $7,200

19. On December 31, 1984, a building owned by Glen Company was totally destroyed by fire. The building was covered by a fire insurance policy with a face value of $250,000. Other pertinent information as of December 31, 1984, is as follows:

Building — at book value	$260,000
Building — at fair value	275,000
Removal and clean-up cost	3,000

During January 1985, before the 1984 financial statements were issued, Glen received insurance proceeds of $250,000. What amount should Glen report on its 1984 income statement as involuntary conversion loss?

a. $10,000
b. $13,000
c. $25,000
d. $28,000

20. During 1983 Dall Company introduced a new product carrying a two-year warranty against defects. The estimated warranty costs related to dollar sales are 2% within 12 months following sale and 4% in the second 12 months following sale. Sales and actual warranty expenditures for the years ended December 31, 1983 and 1984, are as follows:

	Sales	*Actual warranty expenditures*
1983	$300,000	$ 4,500
1984	500,000	15,000
	$800,000	$19,500

At December 31, 1984, Dall should report an estimated warranty liability of
   a. $28,500
   b. $22,500
   c. $ 5,000
   d. $0

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

21. On January 1, 1985, Dean Company issued ten-year bonds with a face value of $1,000,000 and a stated interest rate of 8% per year payable semiannually July 1 and January 1. The bonds were sold to yield 10%. Present value factors are as follows:

Present value of 1 for 10 periods at 10%	.386
Present value of 1 for 20 periods at 5%	.377
Present value of an annuity of 1 for 10 periods at 10%	6.145
Present value of an annuity of 1 for 20 periods at 5%	12.462

The total issue price of the bonds is
   a. $ 875,480
   b. $ 877,600
   c. $ 980,000
   d. $1,000,000

22. Moore Company sells magazine subscriptions for one to three-year periods. The magazine subscriptions collected in advance account had a balance of $1,800,000 at December 31, 1983. Information for the year 1984 is as follows:

Cash receipts from subscribers	$2,300,000
Magazine subscriptions revenue	1,600,000

In its December 31, 1984, balance sheet, how much should Moore report as the balance for magazine subscriptions collected in advance?
   a. $1,100,000
   b. $2,100,000
   c. $2,300,000
   d. $2,500,000

23. On December 31, 1984, Cobb Company leased a new machine from Gill Company. The following data relate to the lease transaction:

- The machine has an estimated useful life of eight years which coincides with the lease term.
- Lease rentals consist of eight equal annual payments of $100,000, the first of which was paid December 31, 1984.
- Gill's implicit interest rate is 12%, which is known by Cobb.
- Cobb's incremental borrowing rate is 14% at December 31, 1984.
- Present value of an annuity of 1 in advance for eight periods at 12% is 5.56.
- Present value of an annuity of 1 in advance for eight periods at 14% is 5.29.

In its December 31, 1984, balance sheet, Cobb should report a capitalized lease liability of
   a. $429,000
   b. $456,000
   c. $529,000
   d. $556,000

24. On January 1, 1985, Carr, Inc., issued its 10% bonds in the face amount of $400,000, which mature on January 1, 1995. The bonds were issued for $354,000 to yield 12%, resulting in a bond discount of $46,000. Carr uses the interest method of amortizing bond discount. Interest is payable semiannually on July 1 and January 1. For the six months ended June 30, 1985, Carr should report bond interest expense at
   a. $24,000
   b. $22,300
   c. $21,240
   d. $20,000

25. Eller Company has outstanding at December 31, 1984, several long-term borrowings with annual sinking fund payments and maturities as follows:

	Sinking fund payments	*Maturities*
1985	$1,000,000	$ —
1986	1,000,000	2,500,000
1987	1,000,000	—
1988	1,500,000	3,000,000
1989	1,500,000	3,000,000
1990	2,000,000	3,000,000

Eller appropriately provides footnote disclosures in its 1984 annual report for long-term borrowings which include sinking fund payments and maturities for each of the next five years. The combined aggregate amount for 1989, the fifth year, should be stated as

a. $4,500,000
b. $5,000,000
c. $7,500,000
d. $9,500,000

26. On January 1, 1981, Bart Company purchased equipment at a cost of $105,000. The equipment was estimated to have a useful life of five years and a salvage value of $15,000. Bart uses the sum-of-the-years'-digits method of depreciation. What should the accumulated depreciation be at December 31, 1984?

a. $98,000
b. $84,000
c. $70,000
d. $60,000

27. Ward Company's usual sales terms are net 60 days, F.O.B. shipping point. Sales, net of returns and allowances, totaled $2,300,000 for the year ended December 31, 1984, before year-end adjustment. Additional data are as follows:

- On December 27, 1984, Ward authorized a customer to return, for full credit, goods shipped and billed at $50,000 on December 15, 1984. The returned goods were received by Ward on January 4, 1985, and a $50,000 credit memo was issued on the same date.
- Goods with an invoice amount of $80,000 were billed to a customer on January 3, 1985. The goods were shipped on December 31, 1984.
- On January 5, 1985, a customer notified Ward that goods billed and shipped on December 23, 1984, were lost in transit. The invoice amount was $100,000.

Ward's adjusted net sales for 1984 should be

a. $2,330,000
b. $2,280,000
c. $2,250,000
d. $2,230,000

28. Green Company, which began operations on January 1, 1984, appropriately uses the installment method of accounting. The following information is available for 1984:

Gross profit on sales	40%
Deferred gross profit at 12/31/84	$240,000
Cash collected, including down payments	450,000

What is the total amount of Green's installment sales for 1984?

a. $ 600,000
b. $ 690,000
c. $ 850,000
d. $1,050,000

29. On January 1, 1984, Rex Company leased a machine to Lee Company for eight years, with $10,000 payments due at the beginning of each year. The machine cost Rex $47,900. The lease is appropriately accounted for as a sales-type lease by Rex. The present value of all rent payments over the lease term discounted appropriately at 10% was $58,700. The estimated salvage value of the machine at the end of eight years is equal to the disposal costs. How much interest income should Rex record from the lease for the year ended December 31, 1984?

a. $4,790
b. $4,870
c. $5,870
d. $7,000

30. Pine Construction, Inc., has consistently used the percentage of completion method of recognizing income. In 1984 Pine started work on a $9,000,000 construction contract, which was completed in 1985. The accounting records disclosed the following data for 1984:

Progress billings	$3,300,000
Costs incurred	2,700,000
Collections	2,100,000
Estimated cost to complete	5,400,000

How much income should Pine have recognized in 1984?

a. $300,000
b. $450,000
c. $600,000
d. $700,000

31. Burg, Inc., issued $500,000 face amount of 10% bonds with interest payable on January 1 and July 1. The bonds were called in at 103 on July 1, 1985, and retired. Unamortized bond discount amounted to $40,000 at July 1, 1985. Burg's income tax rate is 40% for 1985. How much loss should Burg report on this early extinguishment of debt?

a. $15,000
b. $22,000
c. $33,000
d. $55,000

32. Information pertaining to dividends from Fay Company's common stock investments during the year ended December 31, 1984, is as follows:

- Fay owns a 2% interest in Beal Corporation, which declared a cash dividend of $300,000 on November 26, 1984, to shareholders of record on December 21, 1984, and payable on January 10, 1985.
- On October 15, 1984, Fay received a liquidating dividend of $10,000 from Clay Mining Corporation. Fay owns a 5% interest in Clay.

How much dividend income should Fay report in its 1984 income statement?

a. $0
b. $ 6,000
c. $10,000
d. $16,000

33. During 1983 a textbook written by Burr Company personnel was sold to Fox Publishing, Inc., for royalties of 10% on sales. Royalties are receivable semiannually on March 31, for sales in July through December of the prior year, and on September 30, for sales in January through June of the same year.

- Royalty income of $18,000 was accrued at 12/31/83 for the period July — December 1983.
- Royalty income of $20,000 was received on 3/31/84, and $26,000 on 9/30/84.
- Burr learned from Fox that sales subject to royalty were estimated at $270,000 for the last half of 1984.

In its income statement for 1984, Burr should report royalty income at

a. $46,000
b. $48,000
c. $53,000
d. $55,000

34. On January 1, 1985, Kern Company sold a machine to Burns Company. Burns signed a noninterest-bearing note requiring payment of $30,000 annually for seven years. The first payment was made on January 1, 1985. The prevailing rate of interest for this type of note at date of issuance was 10%. Information on present value factors is as follows:

Periods	*Present value of 1 at 10%*	*Present value of ordinary annuity of 1 at 10%*
6	.56	4.36
7	.51	4.87

Kern should record the sale in January 1985 at

a. $107,100
b. $130,800
c. $146,100
d. $160,800

35. Lundy, a U.S. corporation, bought inventory items from a supplier in West Germany on November 5, 1984, for 50,000 marks, when the spot rate was $.4295. At Lundy's December 31, 1984, year end the spot rate was $.4245. On January 15, 1985, Lundy bought 50,000 marks at the spot rate of $.4345 and paid the invoice. How much should Lundy report in its income statements for 1984 and 1985 as foreign exchange gain or (loss)?

	1984	*1985*
a.	$250	($500)
b.	($250)	$0
c.	$0	($250)
d.	$0	$0

36. Hall Company owns an office building and leases the offices under a variety of rental agreements involving rent paid monthly in advance and rent paid annually in advance. Not all tenants make timely payments of their rent. Hall's balance sheets contained the following data:

	1983	*1984*
Rentals receivable	$ 4,800	$ 6,200
Unearned rentals	16,000	12,000

During 1984 Hall received $40,000 cash from tenants. How much rental revenue should Hall record for 1984?

a. $34,600
b. $37,400
c. $42,600
d. $45,400

37. Zeno Menswear, Inc., maintains a markup of 60% based on cost. The company's selling and administrative expenses average 30% of sales. For 1984 sales amounted to $960,000. Zeno's cost of goods sold and operating profit for 1984 are

	Cost of goods sold	*Operating profit*
a.	$576,000	$ 96,000
b.	$576,000	$288,000
c.	$600,000	$ 72,000
d.	$600,000	$288,000

38. On January 1, 1984, Orr Company bought a building which had an assessed value of $220,000 on the date of purchase. Orr gave as consideration a $400,000 noninterest bearing note due on January 1, 1987. There was no established exchange price for the building, and the note had no ready market. The prevailing rate of interest for a note of this type at January 1, 1984, was 10%. The present value of 1 at 10% for three periods is 0.75. What amount of interest expense should be included in Orr's 1984 income statement?

a. $22,000
b. $30,000
c. $33,333
d. $40,000

39. Poe Company's depreciation policy on machinery and equipment is as follows:

- A full year's depreciation is taken in the year of an asset's acquisition.
- No depreciation is taken in the year of an asset's disposition.
- The estimated useful life is five years.
- The straight-line method is used.

On June 30, 1985, Poe sold for $57,500 a machine acquired in 1982 for $105,000. The accumulated depreciation for this machine was $54,000 at December 31, 1984, and the original estimated salvage value was $15,000. How much gain or (loss) on the disposal should Poe record in 1985?

a. $ 3,500
b. $ 6,500
c. ($ 8,500)
d. $15,500

40. In January 1984 Huff Mining Corporation purchased a mineral mine for $3,600,000 with removable ore estimated by geological surveys at 2,160,000 tons. The property has an estimated value of $360,000 after the ore has been extracted. Huff incurred $1,080,000 of development costs preparing the property for the extraction of ore. During 1984, 270,000 tons were removed and 240,000 tons were sold. For the year ended December 31, 1984, Huff should include what amount of depletion in its cost of goods sold?

a. $360,000
b. $405,000
c. $480,000
d. $540,000

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. In October 1984 Allen Company exchanged a used packaging machine, having a book value of $120,000, for a dissimilar new machine and paid a cash difference of $15,000. The market value of the used packaging machine was determined to be $140,000. In its income statement for the year ended December 31, 1984, how much gain should Allen recognize on this exchange?

a. $0
b. $ 5,000
c. $15,000
d. $20,000

42. Colt Company prepared an aging of its accounts receivable at December 31, 1984, and determined that the net realizable value of the receivables is $125,000. Additional information is available as follows:

Allowance for doubtful accounts at 1/1/84 — credit balance	$ 14,000
Accounts written off as uncollectible during 1984	11,500
Accounts receivable at 12/31/84	135,000

For the year ended December 31, 1984, Colt's bad debt expense would be

a. $ 7,500
b. $10,000
c. $11,500
d. $12,500

43. On January 1, 1984, Marsh Company sold an airplane with an estimated useful life of ten years. At the same time, Marsh leased back the airplane for three years under a lease classified as an operating lease. Pertinent data are:

Sales price	$500,000
Book value of airplane	100,000
Monthly rental under leaseback	5,100
Present value of lease rentals	153,000

For the year ended December 31, 1984, Marsh's rent expense for the airplane should be

a. $0
b. $10,200
c. $51,000
d. $61,200

44. On January 3, 1983, Trapp Company purchased as a long-term investment 10,000 shares of Lee Corporation common stock for $30 per share. On December 31, 1983, the market price of the stock was $25 per share, reflecting a temporary decline in market value. On December 10, 1984, Trapp sold all 10,000 shares of Lee stock for $10 per share. For the year ended December 31, 1984, Trapp should include in its income from continuing operations a loss on disposal of long-term investment of

a. $0
b. $ 50,000
c. $150,000
d. $200,000

45. An inventory loss from market decline of $900,000 occurred in May 1984. Kerr Company recorded this loss in May 1984 after its March 31, 1984, quarterly income statement was issued. None of this loss was recovered by the end of 1984. How much of the inventory loss should be recognized in Kerr's quarterly income statement for the three months ended December 31, 1984?

a. $0
b. $225,000
c. $300,000
d. $900,000

46. On January 1, 1984, Beal Corporation granted stock options to key employees for the purchase of 20,000 shares of the company's common stock at $25 per share. The options are intended to compensate employees for the next two years. The options are exercisable within a four-year period beginning January 1, 1986, by grantees still in the employ of the company. The market price of Beal's common stock was $33 per share at the date of grant. No stock options were terminated during the year. How much should Beal charge to compensation expense for the year ended December 31, 1984?

a. $0
b. $ 40,000
c. $ 80,000
d. $160,000

47. Mall Corporation's pretax book income was $1,400,000 for the year ended December 31, 1984. Mall's taxable income for 1984 was $1,200,000, and the difference is due to the following:

Interest on municipal bonds	$ 60,000
Lower depreciation per books	140,000
	$200,000

Assuming an income tax rate of 40%, what is the current portion of Mall's total income tax expense for 1984?

a. $456,000
b. $480,000
c. $536,000
d. $560,000

48. Rice, Inc., incurred the following losses, net of applicable taxes, for the year ended December 31, 1984:

Loss on disposal of a segment of Rice's business	$350,000
Foreign currency transaction loss due to major devaluation	450,000

How much should Rice report as extraordinary losses in its 1984 income statement?

a. $0
b. $350,000
c. $450,000
d. $800,000

49. On January 2, 1982, Garr Company acquired machinery at a cost of $320,000. This machinery was being depreciated by the double declining balance method over an estimated useful life of eight years, with no residual value. At the beginning of 1984, it was decided to change to the straight-line method of depreciation. Ignoring income tax considerations, the cumulative effect of this accounting change is

a. $0
b. $ 60,000
c. $ 65,000
d. $140,000

50. On January 1, 1984, Black Company changed its inventory cost flow method to FIFO from LIFO for both financial statement and income tax reporting purposes. The change resulted in a $600,000 increase in the beginning inventory at January 1, 1984. Ignoring income taxes, the accounting change should be reported by Black in its 1984

a. Income statement as a $600,000 debit.
b. Retained earnings statement as a $600,000 debit adjustment to the beginning balance.
c. Income statement as a $600,000 credit.
d. Retained earnings statement as a $600,000 credit adjustment to the beginning balance.

51. Lewis Company was formed on January 1, 1983. Selected balances from the historical cost balance sheet at December 31, 1984, were as follows:

Land (purchased in 1983)	$120,000
Investment in nonconvertible bonds (purchased in 1983, and expected to be held to maturity)	60,000
Long-term debt	80,000

The average Consumer Price Index was 100 for 1983, and 110 for 1984. In a supplementary constant dollar balance sheet (adjusted for changing prices) at December 31, 1984, these selected account balances should be shown at

	Land	*Investment*	*Long-term debt*
a.	$120,000	$60,000	$88,000
b.	$120,000	$66,000	$88,000
c.	$132,000	$60,000	$80,000
d.	$132,000	$66,000	$80,000

52. At December 31, 1984, Dorr, Inc., has a net operating loss carryforward of $90,000 available to offset future taxable income. At this date, the realization of the tax benefit of the carryforward is probable, but not assured beyond any reasonable doubt. Assuming an income tax rate of 40%, what amount of the potential carryforward tax benefit should be reported in the income statement for the year ended December 31, 1984?

a. $0
b. $36,000
c. $54,000
d. $90,000

53. Mann, Inc., has a bonus plan covering all employees. The total bonus is equal to 10% of Mann's preliminary (prebonus, pretax) income reduced by the income tax (computed on the preliminary income less the bonus itself). Mann's preliminary income for 1984 is $200,000 and the income tax rate is 40%. How much is the bonus for 1984?

a. $10,800
b. $12,000
c. $12,500
d. $20,000

Items 54 and 55 are based on the following data:

Information relating to the capital structure of Parke Corporation is as follows:

	December 31	
	1983	*1984*
Outstanding shares of:		
Common stock	90,000	90,000
Preferred stock, convertible into 30,000 shares of common	30,000	30,000
10% convertible bonds, convertible into 20,000 shares of common	$1,000,000	$1,000,000

During 1984 Parke paid $45,000 dividends on the preferred stock, which is considered a common stock equivalent. The convertible bonds are not considered common stock equivalents. Parke's net income for 1984 was $980,000 and the income tax rate was 40%.

54. For the year ended December 31, 1984, the primary earnings per share is
    a. $10.89
    b. $10.39
    c. $ 8.17
    d. $ 7.79

55. For the year ended December 31, 1984, the fully diluted earnings per share is
    a. $9.82
    b. $8.29
    c. $7.71
    d. $7.43

---

56. Wall Corporation's books disclosed the following information as of and for the year ended December 31, 1984:

Net credit sales	$3,000,000
Net cash sales	480,000
Accounts receivable at beginning	400,000
Accounts receivable at end	800,000

Wall's accounts receivable turnover is
    a. 3.75 times.
    b. 4.35 times.
    c. 5.00 times.
    d. 5.80 times.

Items 57 and 58 are based on the following data:

Mr. & Mrs. Taft are applying for a bank loan and the bank has requested a personal statement of financial condition as of December 31, 1984. Included in their assets and liabilities at this date are the following:

Assets

Mr. Taft owns 50% of the common stock of Dee Corporation. A shareholders' agreement restricts the sale of the stock and, under certain circumstances, requires Dee to repurchase the stock based on the book value of the net assets, plus an agreed amount for goodwill. At December 31, 1984, the buyout value of Taft's stock is $675,000. Mr. Taft's tax basis for his Dee stock is $430,000.

Mrs. Taft owns jewelry appraised on December 31, 1984, at $70,000 by an independent appraiser for insurance purposes. The jewelry, acquired by purchase and gift over a ten-year period, has a total tax basis of $40,000.

Liabilities

The Taft residence is encumbered by a mortgage which is payable in monthly installments of $1,000 through December 1990. Interest at 10% a year is included in the $1,000 monthly payment. The balance of the mortgage principal is $58,000 at December 31, 1984.

Mr. Taft has guaranteed the payment of loans of Dee Corporation under a $300,000 line of credit. The loan balance is $200,000 at December 31, 1984. Dee's financial condition at December 31, 1984, is such that its repayment of the loan balance is reasonably assured.

57. In the Tafts' December 31, 1984, personal statement of financial condition, the Dee Corporation investment and the jewelry should be reported at a total amount of
    a. $470,000
    b. $500,000
    c. $715,000
    d. $745,000

58. In the Tafts' December 31, 1984, personal statement of financial condition, the liabilities listed above should be reported at a total amount of
    a. $ 58,000
    b. $ 72,000
    c. $258,000
    d. $272,000

59. Evan, Inc., discloses supplemental industry segment information. The following data are available for 1984:

Segment	*Sales*	*Traceable operating expenses*
E	$ 500,000	$300,000
F	400,000	250,000
G	300,000	175,000
	$1,200,000	$725,000

Additional 1984 expenses, not included above, are as follows:

Indirect operating expenses	$180,000
General corporate expenses	120,000

Appropriate common expenses are allocated to segments based on the ratio of a segment's sales to total sales. What should be the operating profit for segment G for 1984?
   a. $125,000
   b. $ 80,000
   c. $ 65,000
   d. $ 50,000

60. Selected information from the accounting records of Kay Company is as follows:

Net sales for 1984	$1,800,000
Cost of goods sold for 1984	1,200,000
Inventory at 12/31/83	360,000
Inventory at 12/31/84	312,000

Kay's inventory turnover for 1984 is
   a. 3.57 times.
   b. 3.85 times.
   c. 5.36 times.
   d. 5.77 times.

Number 4 (Estimated time —— 45 to 55 minutes)

Munn, Inc., had the following other noncurrent asset account balances at December 31, 1983:

Patent	$192,000
Accumulated amortization	(24,000)
Deferred income tax charges	36,000

Munn reports as other noncurrent assets any assets that are either intangible or not used directly in its operations.

Transactions during 1984 and other information relating to Munn's other noncurrent assets were as follows:

• The patent was purchased from Grey Company for $192,000 on January 1, 1982, at which date the remaining legal life was 16 years. On January 1, 1984, Munn determined that the useful life of the patent was only eight years from the date of acquisition.

• Deferred income taxes are provided in recognition of timing differences between financial statement and income tax reporting of rent income and warranty expense. The rent received in advance and warranty liability are appropriately considered noncurrent items. For the year ended December 31, 1984: (1) rent collected in advance decreased by $20,000, and (2) product warranty liability increased by $15,000. Munn's income tax rate for 1984 was 40%.

• On January 3, 1984, in connection with the purchase of a trademark from Cody Corporation, the parties entered into a non-competition agreement and a consulting contract. Munn paid Cody $800,000, of which three-quarters was for the trademark, and one-quarter was for Cody's agreement not to compete for a five-year period in the line of business covered by the trademark. Munn considers the life of the trademark to be indefinite. Under the consulting contract, Munn agreed to pay Cody $50,000 annually on January 3 for five years. The first payment was made on January 3, 1984.

• On July 1, 1984, Munn purchased as a long-term investment $1,000,000 face value of Dell Corporation original issue 8% bonds for $923,000. The bonds, which were priced to yield 10%, pay interest semiannually on January 1 and July 1, and mature on July 1, 1989. Munn uses the interest method of amortization.

Required:

a. Prepare a schedule of the expenses for 1984 relating to Munn's other noncurrent asset balances at December 31, 1983, and transactions during 1984. Include in the schedule the deferred income tax charge or credit portion of Munn's total 1984 income tax expense.

b. Prepare the other noncurrent assets section of Munn's balance sheet at December 31, 1984.

Number 5 (Estimated time —— 40 to 50 minutes)

Case, Inc., acquired all of the outstanding $25 par common stock of Frey, Inc., on June 30, 1984, in exchange for 40,000 shares of its $25 par common stock. The business combination meets all conditions for a pooling of interests. On June 30, 1984, Case's common stock closed at $65 per share on a national stock exchange. Both corporations continued to operate as separate businesses maintaining separate accounting records with years ending December 31.

On December 31, 1984, after year-end adjustments and closing nominal accounts, the companies had condensed balance sheet accounts as follows:

	Case	*Frey*
Assets:		
Cash	$ 825,000	$ 330,000
Accounts and other receivables	2,140,000	835,000
Inventories	2,310,000	1,045,000
Land	650,000	300,000
Depreciable assets, net	4,575,000	1,980,000
Investment in Frey, Inc.	2,430,000	—
Long-term investments and other assets	865,000	385,000
	$13,795,000	$4,875,000
Liabilities and Stockholders' Equity:		
Accounts payable and other current liabilities	$ 2,465,000	$1,145,000
Long-term debt	1,900,000	1,300,000
Common stock, $25 par value	3,200,000	1,000,000
Additional paid-in capital	1,850,000	190,000
Retained earnings	4,380,000	1,240,000
	$13,795,000	$4,875,000

Additional information is as follows:

- Case uses the equity method of accounting for its investment in Frey. The investment in Frey has not been adjusted for any intercompany transactions.
- On June 30, 1984, Frey's assets and liabilities had fair values equal to the book balances with the exception of Land, which had a fair value of $550,000.
- On June 15, 1984, Frey paid a cash dividend of $4 per share on its common stock.
- On December 10, 1984, Case paid a cash dividend totaling $256,000 on its common stock.
- On June 30, 1984, immediately before the combination, the stockholders' equities were

	Case	*Frey*
Common stock	$2,200,000	$1,000,000
Additional paid-in capital	1,660,000	190,000
Retained earnings	3,036,000	980,000
	$6,896,000	$2,170,000

- Frey's long-term debt consisted of 10% ten-year bonds issued at face value on March 31, 1978. Interest is payable semiannually on March 31 and September 30. Case had purchased Frey's bonds at face value of $320,000 in 1978, and there was no change in ownership through December 31, 1984.
- During October 1984 Case sold merchandise to Frey at an aggregate invoice price of $720,000, which included a profit of $180,000. At December 31, 1984, one-half of the merchandise remained in Frey's inventory, and Frey had not paid Case for the merchandise purchased.
- The 1984 net income amounts per the separate books of Case and Frey were $890,000 (exclusive of equity in Frey's earnings) and $580,000, respectively.
- The balances in retained earnings at December 31, 1983, were $2,506,000 and $820,000 for Case and Frey, respectively.

Required:

Go to page 13 and remove tear-out worksheet.

a. Complete the tear-out worksheet to prepare a consolidated balance sheet of Case, Inc., and its subsidiary, Frey, Inc., at December 31, 1984. A formal consolidated balance sheet and journal entries are not required. Include the completed tear-out worksheet in the proper sequence with other answer sheets.

b. Prepare a formal consolidated statement of retained earnings for the year ended December 31, 1984.

Uniform Certified Public Accountant Examination
Accounting Practice——Part I
November 1985

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State ____________
Question No. 5 Page ____________

Case, Inc. and Subsidiary
CONSOLIDATED BALANCE SHEET WORKSHEET
December 31, 1984

	Case, Inc.	Frey, Inc.	Adjustments & Eliminations Debit	Adjustments & Eliminations Credit	Consolidated
Assets:					
Cash	$ 825,000	$ 330,000			
Accounts & other receivables	2,140,000	835,000			
Inventories	2,310,000	1,045,000			
Land	650,000	300,000			
Depreciable assets, net	4,575,000	1,980,000			
Investment in Frey, Inc.	2,430,000				
Long-term investments & other assets	865,000	385,000			
	$13,795,000	$4,875,000			
Liabilities and Stockholders' Equity:					
Accounts payable & other current liabilities	$ 2,465,000	$1,145,000			
Long-term debt	1,900,000	1,300,000			
Common stock, $25 par	3,200,000	1,000,000			
Additional paid-in capital	1,850,000	190,000			
Retained earnings	4,380,000	1,240,000			
	$13,795,000	$4,875,000			

EXAMINATION IN ACCOUNTING PRACTICE — PART II

November 7, 1985; 1:30 to 6:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	45	55
No. 2	45	55
No. 3	45	55
No. 4	45	55
No. 5	40	50
Total	220	270

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, the objective answer sheet is page 1 and your other pages should be numbered 2 through 12.
2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the objective answer sheet before the examination time is up.
3. Support **all** problem-type answers with properly labeled and legible calculations that can be identified as sources of amounts in formal schedules, entries, worksheets, or other answers, to show how your final answer was derived. Computation sheets should identify the question to which they relate, be placed immediately following the answer to that question, and be numbered in sequence with the other pages. Failure to enclose supporting calculations may result in loss of grading points because it may be impossible to determine how your amounts were computed.
4. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Number 1 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of managerial and financial accounting problems.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

97. Gross billings for merchandise sold by Baker Company to its customers last year amounted to $5,260,000; sales returns and allowances reduced the amounts owed by $160,000. How much were net sales last year for Baker Company?
   a. $4,800,000
   b. $5,100,000
   c. $5,200,000
   d. $5,260,000

Answer Sheet

97. ⓐ ● ⓒ ⓓ

Items to be Answered

1. Boa Corp. distributes service department overhead costs directly to producing departments without allocation to the other service department. Information for the month of June 1985 is as follows:

	Service Departments	
	Maintenance	*Utilities*
Overhead costs incurred	$20,000	$10,000
Service provided to departments:		
Maintenance		10%
Utilities	20%	
Producing — A	40%	30%
Producing — B	40%	60%
Totals	100%	100%

The amount of maintenance department costs distributed to Producing — A department for June 1985 was
   a. $ 8,000
   b. $ 8,800
   c. $10,000
   d. $11,000

Items 2 and 3 are based on the following data:

Blum Corp. manufactures plastic coated metal clips. The following were among Blum's 1984 manufacturing costs:

Wages	
Machine operators	$200,000
Maintenance workers	30,000
Factory foremen	90,000
Materials used	
Metal wire	$500,000
Lubricant for oiling machinery	10,000
Plastic coating	380,000

2. Blum's 1984 direct labor amounted to
   a. $200,000
   b. $230,000
   c. $290,000
   d. $320,000

3. Blum's 1984 direct materials amounted to
   a. $890,000
   b. $880,000
   c. $510,000
   d. $500,000

4. Tish Co. produces two joint products, Ebo and Gel. Joint production costs for May 1985 were $30,000. During May 1985 further processing costs beyond the split-off point, needed to convert the products into salable form, were $16,000 and $24,000 for 1,600 units of Ebo and 800 units of Gel, respectively. Ebo sells for $25 per unit and Gel sells for $50 per unit. Tish uses the net realizable value method for allocating joint product costs. What were the joint costs allocated to Ebo for May 1985?
   a. $10,000
   b. $12,000
   c. $18,000
   d. $20,000

5. In its July 1985 production, Gage Corp., which does **not** use a standard cost system, incurred total production costs of $800,000, of which Gage attributed $30,000 to normal spoilage and $20,000 to abnormal spoilage. Gage should account for this spoilage as
   a. Inventoriable cost of $30,000 and period cost of $20,000.
   b. Period cost of $30,000 and inventoriable cost of $20,000.
   c. Inventoriable cost of $50,000.
   d. Period cost of $50,000.

6. Lane Co. produces main products Kul and Wu. The process also yields by-product Zef. Net realizable value of by-product Zef is subtracted from joint production cost of Kul and Wu. The following information pertains to production in July 1985 at a joint cost of $54,000:

Product	Units produced	Market value	Additional cost after split-off
Kul	1,000	$40,000	$ 0
Wu	1,500	35,000	0
Zef	500	7,000	3,000

If Lane uses the net realizable value method for allocating joint cost, how much of the joint cost should be allocated to product Kul?

a. $18,800
b. $20,000
c. $26,667
d. $27,342

Items 7 and 8 are based on the following data:

Apex Corp. is planning to buy production machinery costing $100,000. This machinery's expected useful life is five years, with no residual value. Apex requires a rate of return of 20%, and has calculated the following data pertaining to the purchase and operation of this machinery:

Year	Estimated annual cash inflow	Present value of 1, at 20%
1	$ 60,000	.91
2	30,000	.76
3	20,000	.63
4	20,000	.53
5	20,000	.44
Totals	$150,000	3.27

Assuming that the cash inflow was received evenly during the year,

7. The payback period is
a. 2.50 years.
b. 2.75 years.
c. 3.00 years.
d. 5.00 years.

8. The net present value is
a. $ 9,400
b. $ 54,128
c. $ 80,000
d. $109,400

---

9. Information on Rex Co.'s direct material costs for May 1985 is as follows:

Actual quantity of direct materials purchased and used	30,000 lbs.
Actual cost of direct materials	$84,000
Unfavorable direct materials usage variance	$ 3,000
Standard quantity of direct materials allowed for May production	29,000 lbs.

For the month of May, what was Rex's direct materials price variance?

a. $2,800 favorable.
b. $2,800 unfavorable.
c. $6,000 unfavorable.
d. $6,000 favorable.

Items 10 and 11 are based on the following data:

The following condensed balance sheet is presented for the partnership of Lever, Polen, and Quint, who share profits and losses in the ratio of 4:3:3, respectively:

Cash	$ 90,000
Other assets	830,000
Lever, loan	20,000
	$940,000
Accounts payable	$210,000
Quint, loan	30,000
Lever, capital	310,000
Polen, capital	200,000
Quint, capital	190,000
	$940,000

10. Assume that the assets and liabilities are fairly valued on the balance sheet and that the partnership decides to admit Fahn as a new partner, with a 20% interest. No goodwill or bonus is to be recorded. How much should Fahn contribute in cash or other assets?
a. $140,000
b. $142,000
c. $175,000
d. $177,500

11. Assume that instead of admitting a new partner, the partners decide to liquidate the partnership. If the other assets are sold for $700,000, how much of the available cash should be distributed to Lever?
a. $230,000
b. $238,000
c. $258,000
d. $310,000

Items 12 through 16 are based on the following data:

Beef Corporation
STOCKHOLDERS' EQUITY
December 31, 1983

Common stock, $1 par value; authorized 3,000,000 shares; issued 1,500,000 shares; outstanding 1,400,000 shares	$ 1,400,000
Additional paid-in capital:	
In excess of par	14,000,000
From treasury stock	200,000
Total paid-in capital	15,600,000
Unappropriated retained earnings	8,100,000
Total stockholders' equity	$23,700,000

All of the outstanding common stock and treasury stock were originally issued in 1981 for $11.00 per share. The treasury stock is common stock reacquired on March 31, 1983. Beef uses the par value method of accounting for treasury stock.

During 1984 the following events or transactions occurred relating to Beef's stockholders' equity:

- February 12, 1984 — Issued 400,000 shares of unissued common stock for $12.50 per share.
- June 15, 1984 — Declared a cash dividend of $0.20 per share to stockholders of record on April 1, 1984, and payable on April 15, 1984. This was the first dividend ever declared by Beef.
- September 20, 1984 — Beef's president retired. Beef purchased from the retiring president 100,000 shares of Beef's common stock for $13.00 per share, which was equal to market value on this date. This stock was cancelled.
- December 15, 1984 — Declared a cash dividend of $0.20 per share to stockholders of record on January 2, 1985, and payable on January 15, 1985.
- At December 31, 1984, Beef is being sued by two separate parties for patent infringements. Beef's management and outside legal counsel share the following opinions regarding these suits:

Suit	*Likelihood of losing the suit*	*Estimated loss*
#1	Reasonably possible	$600,000
#2	Probable	400,000

12. The issuance of 400,000 shares of common stock on February 12, 1984, caused Beef's additional paid-in capital in excess of par to increase by
    a. $0
    b. $ 400,000
    c. $4,600,000
    d. $5,000,000

13. The retirement of 100,000 shares of common stock on September 20, 1984, caused Beef's additional paid-in capital in excess of par to decrease by
    a. $0
    b. $ 100,000
    c. $1,000,000
    d. $1,200,000

14. Beef wants to appropriate retained earnings for all loss contingencies that are not properly accruable by a charge to expense. How much of Beef's loss contingencies should be appropriated by a charge to unappropriated retained earnings?
    a. $1,000,000
    b. $ 600,000
    c. $ 400,000
    d. $0

15. How much in cash dividends should Beef charge against unappropriated retained earnings in 1984?
    a. $700,000
    b. $680,000
    c. $360,000
    d. $340,000

16. How much should Beef show in notes to financial statements as a restriction on retained earnings because of the acquisition of treasury stock?
    a. $ 200,000
    b. $ 900,000
    c. $1,200,000
    d. $1,300,000

---

17. Platt Co. has been forced into bankruptcy and liquidated. Unsecured claims will be paid at the rate of 50¢ on the dollar. Maga Co. holds a non-interest bearing note receivable from Platt in the amount of $50,000, collateralized by machinery with a liquidation value of $10,000. The total amount to be realized by Maga on this note receivable is
    a. $35,000
    b. $30,000
    c. $25,000
    d. $10,000

Items 18 and 19 are based on the following data:

On January 1, 1984, Neel Corp. issued 400,000 additional shares of $10 par value common stock in exchange for all of Pym Corp.'s common stock. Immediately before this business combination, Neel's stockholders' equity was $16,000,000 and Pym's stockholders' equity was $8,000,000. On January 1, 1984, fair market value of Neel's common stock was $20 per share, and fair market value of Pym's net assets was $8,000,000. Neel's net income for the year ended December 31, 1984, exclusive of any consideration of Pym, was $2,500,000. Pym's net income for the year ended December 31, 1984, was $600,000. During 1984 Neel paid dividends of $900,000. Neel had no business transactions with Pym in 1984.

18. Assuming that this business combination is appropriately accounted for as a pooling of interests, consolidated stockholders' equity at December 31, 1984, should be
    a. $17,600,000
    b. $18,200,000
    c. $26,200,000
    d. $27,100,000

19. Assuming that this business combination is appropriately accounted for as a purchase, consolidated stockholders' equity at December 31, 1984, should be
    a. $17,600,000
    b. $18,200,000
    c. $26,200,000
    d. $27,100,000

20. Bye Co. is considering the sale of banners at the state university football championship game. Bye could purchase these banners for $0.60 each. Unsold banners would be nonreturnable and worthless after the game. Bye would have to rent a booth at the stadium for $250. Bye estimates sales of 500 banners at $2.00 each. If Bye's prediction proves to be incorrect and only 300 banners were sold, the cost of this prediction error would be
    a. $120
    b. $130
    c. $170
    d. $280

Number 2 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of individuals.** Use a soft pencil, preferably No.2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **The answers should be based on the Internal Revenue Code and Tax Regulations in effect for the tax period specified in the item. If *no* tax period is specified, use the *current* Internal Revenue Code and Tax Regulations. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

Items 21 and 22 are based on the following data:

Gary Barth, who is unmarried, owns a house which has been his principal residence for the past ten years. Gary wants to sell this house and move to a rental apartment. He has no intention of buying another residence at any time in the future, but wishes to avail himself of the one-time exclusion of gain on the sale of his house.

21. What is the minimum age Gary must attain in order to avail himself of the one-time exclusion of gain on sale of his house?
    a. 55
    b. 65
    c. 70
    d. 72

22. Assume that Gary has attained the required age to qualify for the one-time exclusion of gain on the sale of his house. What is the maximum amount allowable for this type of exclusion?
    a. 40% of long-term gain.
    b. 60% of long-term gain.
    c. $100,000.
    d. $125,000.

23. Leo Mann, a calendar-year taxpayer, filed his 1984 individual income tax return on March 15, 1985, and attached a check for the balance of tax due as shown on the return. On June 15, 1985, Leo discovered that he had failed to include, in his itemized deductions, $1,000 interest on his home mortgage. In order for Leo to recover the tax that he would have saved by utilizing the $1,000 deduction, he must file an amended return no later than
    a. December 31, 1987.
    b. March 15, 1988.
    c. April 15, 1988.
    d. June 15, 1988.

Items 24 through 27 are based on the following data:

Amy Finch had the following cash receipts during 1984:

Interest on Veterans Administration insurance dividends left on deposit with the V.A.	$ 10
Interest on state income tax refund	18
Net rent on vacant lot used by a car dealer (lessee pays all taxes, insurance, and other expenses on the lot)	6,000
Advance rent from lessee of above vacant lot, such advance to be applied against rent for the last two months of the 5-year lease in 1988	1,000
Dividend from a mutual insurance company on a life insurance policy	500
Dividend on listed corporation stock; payment date by corporation was 12/30/83, but Amy received the dividend in the mail on 1/2/84	875
Gross amount of state lottery winnings (Amy spent $900 on state lottery tickets and $700 on pari-mutuel bets in 1984 at the state off-track betting parlor, for which she has full documentation)	2,400

Amy did not itemize her deductions on her 1984 return. Total dividends received to date on the life insurance policy do not exceed the aggregated premiums paid by Amy.

24. How much should Amy include in her 1984 taxable income for interest?
   a. $0
   b. $10
   c. $18
   d. $28

25. How much should Amy include in her 1984 taxable income for rent?
   a. $7,000
   b. $6,800
   c. $6,200
   d. $6,000

26. How much should Amy report for dividend income for 1984, before any applicable exclusions?
   a. $1,375
   b. $ 875
   c. $ 500
   d. $0

27. How much should Amy include in taxable "Other Income" for her 1984 state lottery winnings?
   a. $2,400
   b. $1,700
   c. $1,500
   d. $ 800

28. Neil and Lynn Barta are married and filed a joint 1984 return. For 1984, how much was the limit on capital losses that the Bartas could apply against other income after offsetting capital gains?
   a. $0
   b. $1,000
   c. $1,500
   d. $3,000

29. Fred Zorn died on January 5, 1985, bequeathing his entire $2,000,000 estate to his sister, Ida. The alternate valuation date was validly elected by the executor of Fred's estate. Fred's estate included 2,000 shares of a listed stock for which Fred's basis was $380,000. This stock was distributed to Ida nine months after Fred's death. Fair market values of this stock were:

At the date of Fred's death	$400,000
Six months after Fred's death	450,000
Nine months after Fred's death	480,000

Ida's basis for this stock is
   a. $380,000
   b. $400,000
   c. $450,000
   d. $480,000

30. Dan Olsen's 1984 taxable income was $75,000. In computing his 1984 federal income tax, Dan was required to use the
   a. Tax Table only if he wanted to use income averaging.
   b. Tax Table even if he did **not** use income averaging.
   c. Tax Rate Schedule only if he wanted to use income averaging.
   d. Tax Rate Schedule even if he did **not** use income averaging.

31. With regard to alimony in connection with a 1985 divorce, which of the following statements is true?
   a. Alimony may be paid either in cash or in property.
   b. Alimony must terminate at the death of the payee spouse.
   c. The divorced couple may be members of the same household at the time alimony is paid.
   d. Alimony may be deductible by the payor spouse to the extent that payment is contingent on the status of the divorced couple's child.

32. In January 1982, Kirk Kelly bought 100 shares of a listed stock for $8,000. In March 1983, when the fair market value was $6,000, Kirk gave this stock to his cousin, Clara. No gift tax was paid. Clara sold this stock in June 1985 for $7,000. How much is Clara's reportable gain or loss in 1985 on the sale of this stock?
  a. $0.
  b. $1,000 loss.
  c. $1,000 gain.
  d. $7,000 gain.

33. For assets acquired in 1985, the holding period for determining long-term capital gains and losses is more than
  a. 18 months.
  b. 12 months.
  c. 9 months.
  d. 6 months.

Items 34 through 36 are based on the following data:

During 1984 Burt Knox made the following unreimbursed personal expenditures:

Interest on note payable to a bank; proceeds of loan were used to buy municipal bonds	$1,000
Payments pertaining to condominium apartment occupied by Burt:	
Interest ($3,000) and principal ($2,200) on mortgage	5,200
Realty taxes	1,800
State and city gasoline taxes	150
State hunting license fee	25
Legal fee for preparation of will	100
Education expenses to qualify for new occupation	975

34. How much interest expense should be included in Burt's 1984 itemized deductions?
  a. $6,200
  b. $5,200
  c. $4,000
  d. $3,000

35. How much should be included in Burt's 1984 itemized deductions for taxes?
  a. $1,800
  b. $1,825
  c. $1,950
  d. $1,975

36. How much should be included in Burt's 1984 itemized deductions for miscellaneous deductions?
  a. $1,075
  b. $ 975
  c. $ 100
  d. $0

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37. Edgar Blair, who is single, did not claim any itemized deductions in his 1984 return because the deductions were less than Edgar's zero bracket amount. In 1984 Edgar contributed $100 to the building fund of his state university. How much was deductible for contributions in Edgar's 1984 return?
  a. $0
  b. $ 12.50
  c. $ 25.00
  d. $100.00

Items 38 and 39 are based on the following data:

Gene Blake, who is single, had an adjusted gross income of $50,000 in 1984. During 1984 Gene paid the following unreimbursed medical and dental expenses:

Medical insurance premiums	$ 300
Dental surgery	5,000

Also in 1984, Gene suffered a $4,000 loss due to vandalism, for which Gene had no insurance. Gene itemized his deductions for 1984.

38. How much was deductible in Gene's 1984 return for medical and dental expenses?
  a. $ 150
  b. $ 300
  c. $2,800
  d. $3,800

39. How much was deductible in Gene's 1984 return as a casualty loss?
  a. $0
  b. $ 100
  c. $3,900
  d. $4,000

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40. In 1984 Alan Kott provided more than half the support for his following relatives, none of whom qualified as a member of Alan's household:

Cousin
Niece
Foster parent

None of these relatives had any income, nor did any of these relatives file an individual or a joint return. All of these relatives are U.S. citizens. Which of these relatives could be claimed as a dependent on Alan's 1984 return?
  a. No one.
  b. Niece.
  c. Cousin.
  d. Foster parent.

Number 3 (Estimated time —— 45 to 55 minutes)

Instructions

Select the **best** answer for each of the following items relating to **the federal income taxation of corporations and partnerships.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **The answers should be based on the Internal Revenue Code and Tax Regulations in effect for the tax period specified in the item. If *no* tax period is specified, use the *current* Internal Revenue Code and Tax Regulations. Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

Items to be Answered

41. Poe Corp. was organized in 1985 with the intention of operating as an S corporation. What is the maximum number of stockholders allowable for eligibility as an S corporation?
   a. 5
   b. 15
   c. 25
   d. 35

42. If a calendar-year S corporation does **not** request an automatic six-month extension of time to file its income tax return, the return is due by
   a. January 31
   b. March 15
   c. April 15
   d. June 30

43. An S corporation is **not** permitted to take a deduction for
   a. Compensation of officers.
   b. Interest paid to individuals who are **not** stockholders of the S corporation.
   c. Charitable contributions.
   d. Employee benefit programs established for individuals who are **not** stockholders of the S corporation.

44. Cava Corp., which has **no** portfolio indebtedness, received the following dividends in 1984:

From a mutual savings bank	$1,500
From an unaffiliated domestic taxable corporation	7,500

How much of these dividends qualifies for the 85% dividends-received deduction?
   a. $9,000
   b. $7,500
   c. $1,500
   d. $0

45. Which of the following is a capital asset?
   a. Machinery used in manufacturing a product.
   b. Treasury stock.
   c. Goodwill.
   d. Real estate used in business operations.

46. During 1984 Ati Corp. had net long-term capital losses of $28,000, net short-term capital gains of $12,000, gains on the sale of Section 1231 property of $6,000, and losses on the sale of Section 1245 property of $8,000. There was no capital loss carryforward from prior years. How much was the capital gains deduction for 1984?
   a. $18,000
   b. $ 7,200
   c. $ 4,800
   d. $0

47. Thor Corporation's operating income for 1984 was $300,000, after consideration of $50,000 for charitable contributions. What was the maximum allowable deduction for contributions in Thor's 1984 return?
   a. $35,000
   b. $30,000
   c. $17,500
   d. $15,000

48. If a corporation's charitable contributions exceed the limitation for deductibility in a particular year, such excess
   a. Is **not** deductible in any future year.
   b. Becomes a carryover to a maximum of 5 succeeding years.
   c. May be carried back to the third preceding year.
   d. Reduces the corporation's capital loss carryback for that year.

49. In the reconciliation of income per books with income per return
   a. Only timing differences are considered.
   b. Only permanent differences are considered.
   c. Both timing and permanent differences are considered.
   d. Neither timing nor permanent differences are considered.

50. The filing of consolidated returns is available
   a. Only to parent-subsidiary corporations.
   b. Only to brother-sister corporations.
   c. Either to parent-subsidiary corporations or to brother-sister corporations.
   d. Neither to parent-subsidiary corporations nor to brother-sister corporations.

51. Of the following tax credits, which one is **not** available to corporations?
   a. Political contributions.
   b. Employee stock ownership.
   c. Alcohol fuel.
   d. Research.

52. The accumulated earnings tax does **not** apply to
   a. Corporations filing consolidated returns.
   b. Corporations that have preferred stock outstanding.
   c. Personal holding companies.
   d. Corporations that have more than 35 stockholders.

53. The personal holding company tax
   a. May be imposed regardless of the number of equal stockholders in a corporation.
   b. Should be self-assessed by filing a separate schedule with the regular tax return.
   c. May be imposed on both corporations and partnerships.
   d. Qualifies as a tax credit which may be used by partners or stockholders to reduce their individual income taxes.

54. When a parent corporation completely liquidates its 80%-owned subsidiary, the parent (as stockholder) will ordinarily
   a. Be subject to capital gains tax on 80% of the long-term gain.
   b. Be subject to capital gains tax on 100% of the long-term gain.
   c. Have to report any gain on liquidation as ordinary income.
   d. Not recognize gain or loss on the liquidating distributions.

55. Reproduced below are the 1984 corporate tax rates:

If the amount on Form 1120, Line 30, Page 1 is:		Enter on Form 1120, Schedule J, Line 3:	
Over—	But not over—		Of the amount over—
0	$25,000	15%	0
$25,000	50,000	$3,750+18%	$25,000
50,000	75,000	8,250+30%	50,000
75,000	100,000	15,750+40%	75,000
100,000	- - - - -	25,750+46%	100,000

Mason Corporation's 1984 taxable income was $80,000. Mason's 1984 tax was
   a. $13,750
   b. $15,750
   c. $17,250
   d. $17,750

56. In computing the ordinary income of a partnership, a deduction is allowed for
   a. Guaranteed payments to partners.
   b. Short-term capital losses.
   c. The first $100 of dividends received from qualifying domestic corporations.
   d. Contributions to recognized charities.

57. A partner's taxable income, arising from the partner's interest in a partnership, includes
   a. Only the partner's share of partnership income actually distributed to the partner during the year.
   b. The partner's share of partnership income, whether or not distributed to the partner during the year.
   c. Only the partner's salary actually paid to the partner during the year.
   d. Only the partner's salary and interest paid to the partner during the year, and deducted by the partnership during that year.

58. In 1982, Lisa Bara acquired a one-third interest in Dee Associates, a partnership. In 1984, when Lisa's entire interest in the partnership was liquidated, Dee's assets consisted of the following: cash, $20,000; tangible property with a basis of $46,000 and a fair market value of $40,000. Dee had no liabilities. Lisa's adjusted basis for her one-third interest was $22,000. Lisa received cash of $20,000 in liquidation of her entire interest. What was Lisa's recognized loss in 1984 on the liquidation of her interest in Dee?
   a. $0.
   b. $2,000 short-term capital loss.
   c. $2,000 long-term capital loss.
   d. $2,000 ordinary loss.

59. A partnership is terminated for tax purposes
   a. Only when it has terminated under applicable local partnership law.
   b. When at least 50% of the total interest in partnership capital and profits changes hands by sale or exchange within 12 consecutive months.
   c. When the sale of partnership assets is made only to an outsider, and **not** to an existing partner.
   d. When the partnership return of income (Form 1065) ceases to be filed by the partnership.

60. For tax purposes, a retiring partner who receives retirement payments ceases to be regarded as a partner
   a. On the last day of the taxable year in which the partner retires.
   b. On the last day of the particular month in which the partner retires.
   c. The day on which the partner retires.
   d. Only after the partner's entire interest in the partnership is liquidated.

Number 4 (Estimated time —— 45 to 55 minutes)

Presented below are the June 30, 1985 and 1984, balance sheets of Dorn Foundation, a nonprofit research and scientific organization:

Dorn Foundation
BALANCE SHEETS
June 30,

	1985	*1984*
Assets		
Current assets		
Cash	$ 650,000	$ 630,000
Accounts receivable	744,000	712,000
Unbilled contract revenues and reimbursable grant expenses	976,000	780,000
Prepaid expenses	80,000	76,000
Total current assets	2,450,000	2,198,000
Investments and endowment fund cash	840,000	780,000
Property, plant, and equipment		
Land and building	440,000	440,000
Furniture and equipment	334,000	312,000
Leased property under capital leases	958,000	958,000
Total property, plant, and equipment	1,732,000	1,710,000
Less accumulated depreciation and amortization	518,000	370,000
Net property, plant, and equipment	1,214,000	1,340,000
Total assets	$4,504,000	$4,318,000
Liabilities and Fund Balances		
Current liabilities		
Accounts payable	$ 836,000	$ 776,000
Restricted grant advances	522,000	420,000
Obligations under capital leases	176,000	164,000
Total current liabilities	1,534,000	1,360,000
Noncurrent capital lease obligations	618,000	794,000
Total liabilities	2,152,000	2,154,000
Fund balances		
Unrestricted	916,000	838,000
Net equity in property, plant, and equipment	596,000	546,000
Endowment	840,000	780,000
Total fund balances	2,352,000	2,164,000
Total liabilities and fund balances	$4,504,000	$4,318,000

Excerpts from Dorn Foundation's Notes to Financial Statements follow:

Revenue recognition — Substantially all of the organization's revenue is derived from restricted grants and cost-plus-fixed-fee contracts. Revenue is recognized based on the proportion of project expenses incurred to total anticipated project expenses (percentage-of-completion method). Losses on contracts are recognized when identified.

Number 4 (continued)

Fund balances — Of the $188,000 increase in fund balances from 1984 to 1985, $128,000 represents the results of current operating activities, and $60,000 represents capital additions from interest earned on endowment fund investments. The endowment fund, in the principal amount of $700,000, was received in 1982. The donor of this fund specified that principal and accumulated interest not be expended until 1990, at which time the fund, including accumulated interest, will be used for environmental research projects. Net equity in property, plant, and equipment is the carrying value of all property, plant, and equipment less related noncurrent liabilities to finance their acquisition. There were no dispositions of property, plant, and equipment during the year.

Lease commitments — The organization uses scientific equipment under capital leases expiring in 1991 which provide for the transfer of ownership of the equipment at the end of the lease term. The related future minimum lease payments as of June 30, 1985, for subsequent fiscal years, are as follows:

1986	$188,000
1987	188,000
1988	188,000
1989	188,000
1990	188,000
1991	20,000
Total	960,000
Less amount representing interest	(166,000)
Present value of minimum lease payments	$794,000

Required:

Prepare the statement of changes in financial position, including the schedule of changes in working capital, for the year ended June 30, 1985.

Number 5 (Estimated time —— 40 to 50 minutes)

Leif Company is faced with the necessity of making the following three unrelated financial management decisions involving its Sigma Division:

a. *Establishment of a selling price for a new product, called Kace, developed by Sigma.* Kace's variable cost is $3 per unit. The following probabilities of reaching annual sales levels for Kace have been estimated:

Sales	*If each unit is sold for*		
(in units)	*$6*	*$7*	*$8*
70,000	10%	40%	70%
80,000	50%	30%	20%
90,000	40%	30%	10%

b. *Discontinuance of a currently produced product and acquisition of a new machine.* Sigma's manager, Baum, has recommended that an unprofitable product, called Sago, be discontinued, which would decrease Sigma's current sales volume by 10%. In addition, Baum wants to improve efficiency by investing $100,000 in a new machine. Baum believes that implementation of his two recommendations would increase the pre-tax income rate on sales to 12%.

Sigma's current rate of pre-tax income is 10% on annual sales of $2,000,000. Financing of these current annual sales requires an investment of $600,000. Leif measures Sigma's performance by the pre-tax accounting rate of return based on the initial investment.

c. *Financing of a distributor.* Cote Corp., which is one of Sigma's distributors, wants to borrow $200,000 from Leif and to repay this loan within three years. As an inducement, Cote is offering Leif a participation in Cote's income for three years. Payments by Cote at the end of each of the three years would include principal plus 5% of Cote's net income for each of these years. The estimated amounts to be remitted by Cote to Leif under this arrangement would be as follows:

At the end of year	*Amount*
1	$ 50,000
2	90,000
3	110,000
Total estimated remittances	$250,000

Leif would be willing to grant Cote's loan request if the annual pre-tax internal rate of return on this loan exceeds Leif's hurdle (discount) rate of 20% on investment. Present value factors yielding 20% are approximately:

Year	*Factor*
1	.8
2	.7
3	.6

Required:

a. As a guide to Leif Company in determining a selling price for Kace, prepare a schedule of the expected annual contribution margin for each of the sales prices proposed for Kace.

b. 1. Compute Leif Company's current pre-tax accounting rate of return on its investment in Sigma Division.

2. Compute Leif Company's expected pre-tax accounting rate of return on its proposed investment in Sigma Division if Baum's two recommendations are implemented.

c. Regarding the possible financing of Cote Corp. by Leif Company, compute the net present value of Leif Company's investment opportunity on the proposed loan to Cote Corp., and state whether the investment would earn Leif a minimum internal rate of return of 20%.

EXAMINATION IN AUDITING

November 7, 1985; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, the objective answer sheet is page 1 and your other pages should be numbered 2 through 12.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the objective answer sheet before the examination time is up.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

96. One of the generally accepted auditing standards specifies that the auditor should
    a. Inspect all property and equipment acquired during the year.
    b. Charge fair fees based on cost.
    c. Make a proper study and evaluation of the existing internal accounting control.
    d. Count client petty cash funds.

Answer Sheet

96. ⓐ ⓑ ● ⓓ

Items to be Answered

1. Which of the following best describes what is meant by generally accepted auditing standards?
    a. Audit objectives generally determined on audit engagements.
    b. Acts to be performed by the auditor.
    c. Measures of the quality of the auditor's performance.
    d. Procedures to be used to gather evidence to support financial statements.

2. When a CPA is requested to perform a review engagement for a nonpublic entity in which the CPA has an immaterial financial interest, the CPA should inform management that the CPA
    a. Will have to disclose the lack of independence in the review report.
    b. Lacks independence and, therefore, may issue a review report, but can **not** issue an auditor's opinion.
    c. Lacks independence and, therefore, is precluded from issuing a review report.
    d. Is considered independent because the financial interest is immaterial and, therefore, the CPA can issue a review report.

3. Quality control for a CPA firm, as referred to in Statements on Quality Control Standards, applies to
    a. Auditing services only.
    b. Auditing and management advisory services.
    c. Auditing and tax services.
    d. Auditing and accounting and review services.

4. In which of the following circumstances would a CPA who audits XM Corporation lack independence?
    a. The CPA and XM's president are both on the board of directors of COD Corporation.
    b. The CPA and XM's president each owns 25% of FOB Corporation, a closely held company.
    c. The CPA has a home mortgage from XM, which is a savings and loan organization.
    d. The CPA reduced XM's usual audit fee by 40% because XM's financial condition was unfavorable.

5. If an auditor detects an illegal act that does **not** have a material effect on the client's financial statements, the auditor should generally
    a. Require that the circumstances be disclosed in the notes to the financial statements.
    b. Require the illegal act be reported to the proper legal authorities.
    c. Report on the illegal act in a separate paragraph of the auditor's report.
    d. Report the circumstances to a high-level officer within the client's firm.

6. A management advisory service engagement, as opposed to a management advisory service consultation, generally involves advice or information given by a CPA that is based upon
    a. An analytical approach and process.
    b. Existing personal knowledge about the client.
    c. An incidental effort devoted to a combination of activities.
    d. The CPA's ability to implement management's recommendations.

7. Which of the following statements best describes why the CPA profession has deemed it essential to promulgate ethical standards and to establish means for ensuring their observance?
    a. A requirement for a profession is the establishment of ethical standards that stress primarily a responsibility to clients and colleagues.
    b. A requirement of most state laws calls for the profession to establish a code of ethics.
    c. An essential means of self-protection for the profession is the establishment of flexible ethical standards by the profession.
    d. A distinguishing mark of a profession is its acceptance of responsibility to the public.

8. In general, material irregularities perpetrated by which of the following are **most** difficult to detect?
    a. Internal auditor.
    b. Key-punch operator.
    c. Cashier.
    d. Controller.

9. In planning a new engagement, which of the following is **not** a factor that affects the CPA's judgment as to the quantity, type, and content of working papers?
   a. The content of the client's representation letter.
   b. The type of report to be issued by the CPA.
   c. The CPA's estimated occurrence rate of attributes.
   d. The CPA's preliminary evaluations based on discussions with the client.

10. A prospective client's refusal to grant a CPA permission to communicate with the predecessor auditor will bear directly on the CPA's ability to
   a. Study and evaluate the client's system of internal control.
   b. Determine the integrity of management.
   c. Determine the beginning balances of the current year's financial statements.
   d. Establish consistency in application of GAAP between years.

11. With respect to errors and irregularities, the auditor should plan to
   a. Search for errors or irregularities that would have a material effect on the financial statements.
   b. Discover errors or irregularities that have either material or immaterial effect on the financial statements.
   c. Search for errors that would have a material effect and for irregularities that would have either material or immaterial effect on the financial statements.
   d. Search for irregularities that would have a material effect and for errors that would have either material or immaterial effect on the financial statements.

12. The technical standards that apply to MAS engagements require the MAS practitioner to do all of the following **except**
   a. Maintain independence from the client.
   b. Give support for and clearly identify as estimates any quantifiable results that are based on estimates.
   c. Obtain an understanding concerning the nature, scope, and limitations of the MAS engagement to be performed.
   d. Take no position which might impair the practitioner's objectivity.

13. The first general standard recognizes that regardless of how capable an individual may be in other fields, the individual can **not** meet the requirements of the auditing standards without the proper
   a. Business and finance courses.
   b. Quality control and peer review.
   c. Education and experience in auditing.
   d. Supervision and review skills.

14. The third general standard states that due care is to be exercised in the performance of the examination. This standard means that a CPA who undertakes an engagement assumes a duty to perform each audit
   a. As a professional possessing the degree of skill commonly possessed by others in the field.
   b. In conformity with generally accepted accounting principles.
   c. With reasonable diligence and without fault or error.
   d. To the satisfaction of governmental agencies and investors who rely upon the audit.

15. The independent auditor selects several transactions in each functional area and traces them through the entire system, paying special attention to evidence about whether or not the control features are in operation. This is an example of a
   a. Control test.
   b. Compliance test.
   c. Substantive test.
   d. Functional test.

16. In the evaluation of internal accounting control, the auditor is basically concerned that the system provides reasonable assurance that
   a. Management can **not** override the system.
   b. Operational efficiency has been achieved in accordance with management plans.
   c. Errors have been prevented or detected.
   d. Controls have **not** been circumvented by collusion.

17. Which of the following statements with respect to the independent auditor's evaluation of internal accounting control is correct?
   a. The auditor should decrease compliance testing when weaknesses in cash receipts are mitigated by strong controls in cash disbursement procedures.
   b. The auditor should increase compliance testing when weaknesses in billing procedures are mitigated by strong controls in collection procedures.
   c. The auditor generally should **not** evaluate separately procedures that result in entries to particular accounts but should confine the evaluation to broad classes of transactions.
   d. The auditor should evaluate all internal accounting control weaknesses before determining the accounting control procedures that should prevent or detect errors and irregularities.

18. When evaluating an internal accounting control system to determine whether the necessary procedures are prescribed and are followed satisfactorily, an auditor must
   a. Develop questionnaires and checklists.
   b. Review the system and perform compliance tests.
   c. Perform compliance and analytical review tests.
   d. Evaluate administrative policies.

19. Tracing bills of lading to sales invoices will provide evidence that
    a. Recorded sales were shipped.
    b. Invoiced sales were shipped.
    c. Shipments to customers were invoiced.
    d. Shipments to customers were recorded as sales.

20. Which of the following accounts would most likely be reviewed by the auditor to gain reasonable assurance that additions to the equipment account are **not** understated?
    a. Repairs and maintenance expense.
    b. Depreciation expense.
    c. Gain on disposal of equipment.
    d. Accounts payable.

Items 21 through 26 are based on the following information:

Hickory, Inc., is a small manufacturer. Its office building, plant, and warehouse are all located in Zena, Ohio. William Cream is the principal owner and president of Hickory.

Hickory is not a publicly-held corporation. The primary uses of the financial statements are for its 15 shareholders and for bank credit purposes. Hickory's financial statements have never been audited or reviewed.

On July 18, 1984, William Cream hired the CPA firm of Part & Co. to audit Hickory's financial statements for the year ended December 31, 1984. Part & Co. performed the audit field work from December 15, 1984, through March 10, 1985.

Part & Co. has offices in Cleveland, the office that performed the Hickory audit, and Chicago.

21. After the preliminary phase of the review of Hickory's internal accounting controls, Part & Co. decided not to perform compliance testing, but rather to restrict audit procedures to substantive testing. Part has probably decided that Hickory's internal accounting controls are
    a. Adequate enough to justify reliance on them.
    b. So good that compliance testing would provide little benefit.
    c. So inadequate that the performance of compliance tests would **not** provide a basis for reliance on them.
    d. So inadequate that Part does **not** even understand the flow of transactions, and therefore it would be impossible to perform compliance testing.

22. Hickory's client representation letter should be dated
    a. July 18, 1984.
    b. December 15, 1984.
    c. December 31, 1984.
    d. March 10, 1985.

23. If Part & Co. were able to examine satisfactory evidence for all items in the financial statements **except** verification of Hickory's January 1, 1984, inventory quantities, Part's opinion on Hickory's 1984 financial statements will probably be
    a. A disclaimer for both the balance sheet and income statement.
    b. A disclaimer for the balance sheet and unqualified for the income statement.
    c. Unqualified for the balance sheet and "subject to" for the income statement.
    d. Unqualified for the balance sheet and a disclaimer for the income statement.

24. Hickory will present comparative financial statements for 1983 and 1984. What procedures should Part & Co. adopt relating to the 1983 financial information?
    a. Part should perform sufficient analytical review procedures in order to assure that there are only immaterial differences between 1983 balances and 1984 balances.
    b. Part should perform sufficient procedures in order to assure that accounting principles employed are consistent between 1983 and 1984.
    c. Since the 1983 financial statements are included with the audited 1984 financial statements, Part must perform an examination of the 1983 financial statements in accordance with GAAS.
    d. Since the 1983 financial statements are unaudited, **no** procedures are required.

25. Which of the following subsequent events occurring between January 1, 1985 and March 10, 1985, would cause Hickory to adjust its 1984 financial statements?
    a. Short-term investments' aggregate market value declined substantially below cost.
    b. Hickory sold its accounts receivable to a local financial institution.
    c. Hickory issued common stock to settle a current liability that existed as of the balance sheet date.
    d. William Cream sold all of his common stock in Hickory to Hickory.

26. In order for Part & Co. to be considered independent with respect to the Hickory audit, which of the following individuals would most likely be permitted to own an immaterial direct financial interest in Hickory?
    a. Professional employees at either office.
    b. Professional employees at the Chicago office.
    c. Professional employees and partners at the Chicago office.
    d. None of the professional employees or partners at either office.

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27. The purpose of segregating the duties of distributing payroll checks and hiring personnel is to separate the
    a. Duties within the accounting function.
    b. Custody of assets from the accounting for those assets.
    c. Authorization of transactions from the custody of related assets.
    d. Operational responsibility from record keeping responsibility.

28. If the perpetual inventory records show lower quantities of inventory than the physical count, an explanation of the difference might be unrecorded
    a. Sales.
    b. Sales discounts.
    c. Purchases.
    d. Purchase discounts.

29. In estimation sampling for variables, which of the following must be known in order to estimate the appropriate sample size required to meet the auditor's needs in a given situation?
    a. The qualitative aspects of errors.
    b. The total dollar amount of the population.
    c. The acceptable level of risk.
    d. The estimated rate of error in the population.

30. When an independent auditor reports on internal accounting control based on criteria established by governmental agencies, the report should
    a. Not include the agency's name in the report.
    b. Indicate matters covered by the study and whether the auditor's study included tests of compliance with the procedures covered by the study.
    c. Not express a conclusion based on the agency's criteria.
    d. Assume responsibility for the comprehensiveness of the criteria established by the agency and include recommendations for corrective action.

31. The most important function of generalized audit software is the capability to
    a. Access information stored on computer files.
    b. Select a sample of items for testing.
    c. Evaluate sample test results.
    d. Test the accuracy of the client's calculations.

32. When testing a computerized accounting system, which of the following is **not** true of the test data approach?
    a. The test data need consist of only those valid and invalid conditions in which the auditor is interested.
    b. Only one transaction of each type need be tested.
    c. Test data are processed by the client's computer programs under the auditor's control.
    d. The test data must consist of all possible valid and invalid conditions.

33. If an auditor has **not** gathered sufficient evidential matter to support the management assertions that are embodied in the financial statements, the auditor may either issue a(an)
    a. Disclaimer of opinion or "except for" qualified opinion.
    b. Adverse opinion or disclaimer of opinion.
    c. Adverse opinion or "except for" qualified opinion.
    d. Disclaimer of opinion or "subject to" qualified opinion.

34. When counting cash on hand the auditor must exercise control over all cash and other negotiable assets to prevent
    a. Theft.
    b. Irregular endorsement.
    c. Substitution.
    d. Deposits-in-transit.

35. Which of the following is **not** one of the independent auditor's objectives regarding the examination of inventories?
    a. Verifying that inventory counted is owned by the client.
    b. Verifying that the client has used proper inventory pricing.
    c. Ascertaining the physical quantities of inventory on hand.
    d. Verifying that all inventory owned by the client is on hand at the time of the count.

36. Which of the following statements concerning the independent auditor's required communication of material weaknesses in internal accounting controls is correct?
    a. Weaknesses reported at interim dates must be repeated in the final communication.
    b. If the auditor does **not** become aware of any material weaknesses during the examination, that fact must be communicated.
    c. Weaknesses that had been reported in prior years' communications and have **not** been corrected need **not** be repeated in the current year's communication.
    d. Although written communication is preferable, the auditor may communicate the findings orally.

37. If the independent auditors decide that the work performed by the internal auditor may have a bearing on their own procedures, they should consider the internal auditor's
    a. Competence and objectivity.
    b. Efficiency and experience.
    c. Independence and review skills.
    d. Training and supervisory skills.

Items 38 and 39 are based on the following information:

The diagram below depicts the auditor's estimated deviation rate compared with the tolerable rate, and also depicts the true population deviation rate compared with the tolerable rate.

	True State of Population	
Auditor's Estimate Based On Sample Results	Deviation Rate Exceeds Tolerable Rate	Deviation Rate is Less Than Tolerable Rate
Deviation Rate Exceeds Tolerable Rate	I.	II.
Deviation Rate is Less Than Tolerable Rate	III.	IV.

38. In which of the situations would the auditor have properly relied on internal control?
    a. I.
    b. II.
    c. III.
    d. IV.

39. As a result of compliance testing, the auditor underrelies on internal accounting control and thereby increases substantitve testing. This is illustrated by situation
    a. I.
    b. II.
    c. III.
    d. IV.

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40. The existence of a related party transaction may be indicated when another entity
    a. Sells real estate to the corporation at a price that is comparable to its appraised value.
    b. Absorbs expenses of the corporation.
    c. Borrows from the corporation at a rate of interest which equals the current market rate.
    d. Lends to the corporation at a rate of interest which equals the current market rate.

41. Smith is engaged in the audit of a cable TV firm which services a rural community. All receivable balances are small, customers are billed monthly, and internal control is effective. To determine the validity of the accounts receivable balances at the balance sheet date, Smith would most likely
    a. Send positive confirmation requests.
    b. Send negative confirmation requests.
    c. Examine evidence of subsequent cash receipts instead of sending confirmation requests.
    d. Use statistical sampling instead of sending confirmation requests.

42. To test for unsupported entries in the ledger, the direction of audit testing should be from the
    a. Journal entries.
    b. Ledger entries.
    c. Original source documents.
    d. Externally generated documents.

43. Which of the following procedures is **least** likely to be performed before the balance sheet date?
    a. Confirmation of receivables.
    b. Search for unrecorded liabilities.
    c. Observation of inventory.
    d. Review of internal accounting control over cash disbursements.

44. Which of the following is **least** likely to include a reference to the use of a specialist?
    a. Unqualified opinion.
    b. Adverse opinion.
    c. "Except for" qualified opinion.
    d. "Subject to" qualified opinion.

45. Which of the following is **not** an audit procedure which the independent auditor would perform with respect to litigation, claims, and assessments?
    a. Inquire of and discuss with management the policies and procedures adopted for identifying, evaluating, and accounting for litigation, claims, and assessments.
    b. Obtain from management a description and evaluation of litigation, claims, and assessments that existed at the balance sheet date.
    c. Obtain assurance from management that it has disclosed all unasserted claims that the lawyer has advised are probable of assertion and must be disclosed.
    d. Confirm directly with the client's lawyer that all claims have been recorded in the financial statements.

46. To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should consider all of the following **except**
    a. Tolerable error.
    b. Deviation rate.
    c. Allowable risk of incorrect acceptance.
    d. Characteristics of the population.

47. Which of the following would provide the best form of evidential matter pertaining to the annual valuation of a long-term investment in which the independent auditor's client owns a 30% voting interest?
   a. Market quotations of the investee company's stock.
   b. Current fair value of the investee company's assets.
   c. Historical cost of the investee company's assets.
   d. Audited financial statements of the investee company.

48. The size of a sample designed for dual purpose testing should be
   a. The larger of the samples that would otherwise have been designed for the two separate purposes.
   b. The smaller of the samples that would otherwise have been designed for the two separate purposes.
   c. The combined total of the samples that would otherwise have been designed for the two separate purposes.
   d. More than the larger of the samples that would otherwise have been designated for the two separate purposes, but less than the combined total of the samples that would otherwise have been designed for the two separate purposes.

49. Which of the following statements about working papers is correct?
   a. Working papers are **not** permitted to be used as a reference source by the client.
   b. Documentation of an auditor's understanding of client's internal accounting control system may **not** be necessary.
   c. Working papers may be regarded as a substitute for the client's accounting records.
   d. When reporting on comparative financial statements the independent auditor may discard working papers after two years.

50. A primary purpose of an operational audit is to provide
   a. The results of internal examinations of financial and accounting matters to a company's top-level management.
   b. A measure of management performance in meeting organizational goals.
   c. A means of assurance that internal accounting controls are functioning as planned.
   d. Aid to the independent auditor, who is conducting the examination of the financial statements.

51. When auditing "around" the computer, the independent auditor focuses solely upon the source documents and
   a. Test data.
   b. EDP processing.
   c. Compliance techniques.
   d. EDP output.

52. What type of EDP system is characterized by data that are assembled from more than one location and records that are updated immediately?
   a. Microcomputer system.
   b. Minicomputer system.
   c. Batch processing system.
   d. Online real-time system.

53. Restrictions imposed by the client, Rex Company, prohibit the confirmation of accounts receivable by direct communication with debtors. These receivables account for 30% of all assets and alternative audit procedures can **not** be applied, although the independent auditor was able to examine satisfactory evidence for all other items in the financial statements. The independent auditor should issue a(an)
   a. Disclaimer of opinion.
   b. Adverse opinion.
   c. "Subject to" qualified opinion.
   d. "Except for" qualified opinion.

54. If an auditor dates the auditor's report on financial statements for the year ended December 31, 1984, as of February 10, 1985, except for Note J, as to which the date is March 3, 1985, the auditor is taking responsibility for
   a. All subsequent events occurring through March 3, 1985.
   b. All subsequent events occurring through February 10, 1985 only.
   c. All subsequent events occurring through February 10, 1985, and the specific subsequent event referred to in Note J through March 3, 1985.
   d. Only the specific subsequent event referred to in Note J through March 3, 1985.

55. The independent auditor has concluded that a substantial doubt remains about a client's ability to continue in existence, but the client's financial statements have properly disclosed all of its solvency problems. The auditor would probably issue a(an)
   a. Unqualified opinion with appropriate reference to the middle paragraph.
   b. "Except for" qualified opinion.
   c. "Subject to" qualified opinion.
   d. Adverse opinion.

56. A public entity that is required to present information on the effects of changing prices pursuant to FASB statement No. 33 does not present the effects of changing prices in its annual report. The auditors have decided to issue the standard scope paragraph and include a separate paragraph in the auditors' report that will call attention to the omission of the effects of changing prices required by the FASB. Assuming **no** other problems exist, the auditors should express a(an)
   a. Unqualified opinion.
   b. "Subject to" qualified opinion.
   c. Adverse opinion.
   d. "Except for" qualified opinion.

57. The independent auditors for Louis, Inc., a publicly held company, conclude that their omission of an audit procedure considered necessary at the time of the examination impairs their present ability to support the previously expressed opinion. If they believe there are persons currently relying on the report, they should promptly

a. Undertake to apply the omitted procedure or alternate procedures that would provide a satisfactory basis for the opinion.
b. Notify the board of directors that the previously expressed opinion is not to be relied upon.
c. Notify the stockholders currently relying on the report that the previously expressed opinion is not to be relied upon.
d. Notify the Securities and Exchange Commission that the previously expressed opinion is not to be relied upon.

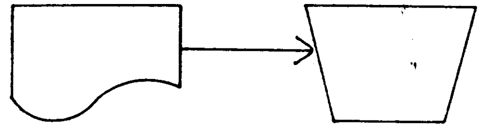
58. The report of a CPA on a review of the financial statements of a nonpublic entity should **not** include a statement that

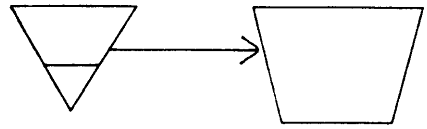
a. All information included in the financial statements is the representation of the owners of the entity.
b. The review was performed in accordance with generally accepted auditing standards.
c. The CPA is **not** aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.
d. A review consists principally of inquiries of company personnel and analytical procedures applied to financial data.

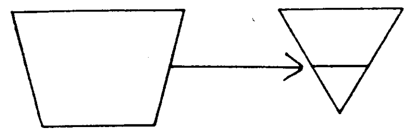
59. After properly communicating with the predecessor auditor, Seal & Co., CPAs, accepted the engagement to audit Mass Company's annual financial statements. Mass desires that comparative statements from years audited by the predecessor auditor be presented in the annual report. The predecessor auditor's report will not be presented. What effect would inclusion of such comparative financial statements have on the auditors' report of Seal?

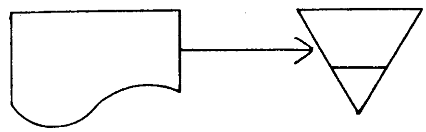
a. Seal should make **no** reference to the report of the predecessor auditor in the scope paragraph.
b. Seal should make reference to the report of the predecessor auditor in both the scope and opinion paragraphs.
c. Seal should make reference to the report of the predecessor auditor in the opinion paragraph only.
d. Seal should make **no** reference to the report of the predecessor auditor in the opinion paragraph.

60. Which of the following symbolic representations indicates that a sales invoice has been filed?

a. 

b. 

c. 

d. 

Number 2 (Estimated time —— 15 to 25 minutes)

The CPA firm of May & Marty has audited the consolidated financial statements of BGI Corporation. May & Marty performed the examination of the parent company and all subsidiaries except for BGI-Western Corporation, which was audited by the CPA firm of Dey & Dee. BGI-Western constituted approximately 10% of the consolidated assets and 6% of the consolidated revenue.

Dey & Dee issued an unqualified opinion on the financial statements of BGI-Western. May & Marty will be issuing an unqualified opinion on the consolidated financial statements of BGI.

Required:

a. What procedures should May & Marty consider performing with respect to Dey & Dee's examination of BGI-Western's financial statements that will be appropriate whether or not reference is to be made to the other auditors?

b. Describe the various circumstances under which May & Marty could take responsibility for the work of Dey & Dee and make no reference to Dey & Dee's examination of BGI-Western in May & Marty's auditor's report on the consolidated financial statements of BGI.

Number 3 (Estimated time —— 15 to 25 minutes)

On March 12, 1985, Brown & Brown, CPAs, completed the audit engagement of the financial statements of Modern Museum, Inc., for the year ended December 31, 1984. Modern Museum presents comparative financial statements on a modified cash basis. Assets, liabilities, fund balances, support, revenues, and expenses are recognized when cash is received or disbursed, except that Modern includes a provision for depreciation of buildings and equipment. Brown & Brown believes that Modern's three financial statements, prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, are adequate for Modern's needs and wishes to issue an auditor's special report on the financial statements. Brown & Brown has gathered sufficient competent evidential matter in order to be satisfied that the financial statements are fairly presented according to the modified cash basis. Brown & Brown audited Modern's 1983 financial statements and issued the auditor's special report expressing an unqualified opinion.

Required:

Draft the auditors' report to accompany Modern's comparative financial statements.

Number 4 (Estimated time —— 15 to 25 minutes)

The CPA firm of Wright & Co. is in the process of examining William Corporation's 1984 financial statements. The following open matters must be resolved before the audit can be completed:

(1) No audit work has been performed on nonresponses to customer accounts receivable confirmation requests. Both positive and negative confirmations were used. A second request was sent to debtors who did not respond to the initial positive request.

(2) The client representation letter has not been completed and signed by William's management. Wright has started to outline the content of the representation letter and believes the following matters should be included in the letter: Management should acknowledge whether or not

- All material transactions have been properly reflected in the financial statements.
- It is aware of irregularities that could have a material effect on the financial statements or that involve management or employees.
- Events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.
- There are any communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
- The company has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- There are any plans or intentions that may materially affect the carrying value or classification of assets or liabilities.
- There are any losses from sales commitments.
- There are any losses from purchase commitments for inventory quantities in excess of requirements or at prices in excess of market.
- There are any agreements to repurchase assets previously sold.
- There are any violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
- There are any capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.

Required:

a. What alternative audit procedures should Wright consider performing on the nonresponses to customer accounts receivable confirmation requests?

b. Identify the other matters that Wright would expect to be included in William's management representation letter.

Number 5 (Estimated time —— 15 to 25 minutes)

In 1984 XY Company purchased over $10 million of office equipment under its "special" ordering system, with individual orders ranging from $5,000 to $30,000. "Special" orders entail low volume items which have been included in an authorized user's budget. Department heads include in their annual budget requests the types of equipment and their estimated cost. The budget, which limits the types and dollar amounts of office equipment a department head can requisition, is approved at the beginning of the year by the board of directors. Department heads prepare a purchase requisition form for equipment and forward the requisition to the purchasing department. XY's "special" ordering system functions as follows:

Purchasing: Upon receiving a purchase requisition, one of five buyers verifies that the person requesting the equipment is a department head. The buyer then selects the appropriate vendor by searching the various vendor catalogs on file. The buyer then phones the vendor, requesting a price quotation, and gives the vendor a verbal order. A prenumbered purchase order is then processed with the original sent to the vendor, a copy to the department head, a copy to receiving, a copy to accounts payable, and a copy filed in the open requisition file. When the buyer is orally informed by the receiving department that the item has been received, the buyer transfers the purchase order from the unfilled file to the filled file. Once a month the buyer reviews the unfilled file to follow up and expedite open orders.

Receiving: The receiving department receives a copy of the purchase order. When equipment is received the receiving clerk stamps the purchase order with the date received, and, if applicable, in red pen prints any differences between quantity on the purchase order and quantity received. The receiving clerk forwards the stamped purchase order and equipment to the requisitioning department head and orally notifies the purchasing department.

Accounts payable: Upon receipt of a purchase order, the accounts payable clerk files the purchase order in the open purchase order file. When a vendor invoice is received, the invoice is matched with the applicable purchase order, and a payable is set up by debiting the equipment account of the department requesting the items. Unpaid invoices are filed by due date and, at due date, a check is prepared. The invoice and purchase order are filed by purchase order number in a paid invoice file, and then the check is forwarded to the treasurer for signature.

Treasurer: Checks received daily from the accounts payable department are sorted into two groups: those over $10,000 and those $10,000 and less. Checks for $10,000 and less are machine-signed. The cashier maintains the key and signature plate to the check-signing machine, and maintains a record of usage of the check-signing machine. All checks over $10,000 are signed by the treasurer or the controller.

Required:

Describe the internal accounting control weaknesses relating to purchases and payments of "special" orders of XY Company for each of the following functions:

a. Purchasing,
b. Receiving,
c. Accounts payable, and
d. Treasurer.

EXAMINATION IN BUSINESS LAW

(Commercial Law)

November 8, 1985; 8:30 A.M. to 12:00 M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	Estimated Minutes Minimum	Estimated Minutes Maximum
No. 1	110	130
No. 2	15	20
No. 3	15	20
No. 4	15	20
No. 5	15	20
Total	170	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, the objective answer sheet is page 1 and your other pages should be numbered 2 through 12.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the objective answer sheet before the examination time is up.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Number 1 (Estimated time —— 110 to 130 minutes)

Instructions

Select the **best** answer for each of the following items. Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The text of the letter from Bridge Builders, Inc., to Allied Steel Co. follows:

> We offer to purchase 10,000 tons of No. 4 steel pipe at today's quoted price for delivery two months from today. Your acceptance must be received in five days.

Bridge Builders intended to create a (an)

a. Option contract.
b. Unilateral contract.
c. Bilateral contract.
d. Joint contract.

Answer Sheet

99. ⓐ ⓑ ● ⓓ

Items to be Answered

1. Which of the following is a characteristic of an unincorporated association?
   a. It may only be used for not-for-profit purposes.
   b. Members who actively manage the association may be held personally liable for contracts they enter into on behalf of the association.
   c. Certificates representing ownership in the association must be distributed to the members.
   d. Its duration must be for a limited period of time **not** to exceed 12 months.

2. Orr Corp. declared a 7% stock dividend on its common stock. The dividend
   a. Is includable in the gross income of the recipient taxpayers in the year of receipt.
   b. Must be registered with the SEC pursuant to the Securities Act of 1933.
   c. Requires a vote of the shareholders of Orr.
   d. Has no effect on the earnings and profits for federal income tax purposes.

Items 3 and 4 are based on the following information:

Jane Cox, a shareholder of Mix Corp., has properly commenced a derivative action against Mix's Board of Directors. Cox alleges that the Board breached its fiduciary duty and was negligent by failing to independently verify the financial statements prepared by management upon which Smart & Co., CPAs, issued an unqualified opinion. The financial statements contained inaccurate information which the Board relied upon in committing large sums of money to capital expansion. This resulted in Mix having to borrow money at extremely high interest rates to meet current cash needs. Within a short period of time, the price of Mix Corp. stock declined drastically.

3. Which of the following statements is correct?
   a. The Board is strictly liable, regardless of fault, since it owes a fiduciary duty to both the corporation and the shareholders.
   b. The Board is liable since any negligence of Smart is automatically imputed to the Board.
   c. The Board may avoid liability if it acted in good faith and in a reasonable manner.
   d. The Board may avoid liability in all cases where it can show that it lacked scienter.

4. If the court determines that the Board was negligent and the Board seeks indemnification for its legal fees from Mix, which of the following statements is correct?
   a. The Board may **not** be indemnified since a presumption that the Board failed to act in good faith arises from the judgment.
   b. The Board may **not** be indemnified unless Mix's shareholders approve such indemnification.
   c. The Board may be indemnified by Mix only if Mix provides liability insurance for its officers and directors.
   d. The Board may be indemnified by Mix only if the court deems it proper.

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5. Rice is a promoter of a corporation to be known as Dex Corp. On January 1, 1985, Rice signed a nine-month contract with Roe, a CPA, which provided that Roe would perform certain accounting services for Dex. Rice did not disclose to Roe that Dex had not been formed. Prior to the incorporation of Dex on February 1, 1985, Roe rendered accounting services pursuant to the contract. After rendering accounting services for an additional period of six months pursuant to the contract, Roe was discharged without cause by the board of directors of Dex. In the absence of any agreements to the contrary, who will be liable to Roe for breach of contract?
   a. Both Rice and Dex.
   b. Rice only.
   c. Dex only.
   d. Neither Rice nor Dex.

6. On May 1, Apple mailed a signed offer to sell an office building to Fein for $90,000. The offer indicated that it would remain open until May 10. On May 5, Fein assigned the offer to Boyd for $5,000. On May 8, Boyd orally accepted Apple's offer. Apple refused to sell the building to Boyd. Which of the following statements is correct?
   a. Fein's assignment to Boyd was effective because an option contract was formed between Apple and Fein on May 1.
   b. Fein's assignment to Boyd was effective against Apple because valid consideration was given.
   c. Boyd's acceptance was ineffective because the offer could **not** be assigned.
   d. Boyd's acceptance was ineffective against Apple because it was oral.

7. Fenster Corp. requested Wein & Co., CPAs, to perform accounting services for it. Wein agreed to perform the services. Fenster and Wein had not discussed the amount of the fees. Which of the following is correct?
   a. No contract was formed since the amount of the fees was **not** agreed upon.
   b. A quasi contract was formed at the time Wein agreed to perform the services.
   c. A unilateral contract was formed at the time of Fenster's request.
   d. A bilateral contract was formed at the time of Wein's agreement to perform.

8. In order for an offer to confer the power to form a contract by acceptance, it must have all of the following elements **except**
   a. Be sufficiently definite and certain.
   b. Manifest an intent to enter into a contract.
   c. Be communicated by words to the offeree by the offeror.
   d. Be communicated to the offeree and the communication must be made or authorized by the offeror.

9. The statute of frauds
   a. Requires the formalization of a contract in a single writing.
   b. Applies to all contracts having a consideration valued at $500 or more.
   c. Applies to the sale of real estate but **not** to any leases.
   d. Does **not** require that the contract be signed by all parties.

10. One of the elements necessary to establish fraud is that
   a. There was a written misrepresentation of fact.
   b. The defendant was in a position of trust and confidence with respect to the plaintiff.
   c. The defendant made a false statement with actual or constructive knowledge of its falsity.
   d. The plaintiff was induced to enter into a contract as the result of an improper threat by the defendant.

11. On April 1, Knox signed and mailed a letter containing an offer to sell Wax a warehouse for $75,000. The letter also indicated that the offer would expire on May 3. Which of the following is correct?
   a. The offer is a firm offer under the UCC and can **not** be withdrawn by Knox prior to May 3.
   b. Wax can benefit from the early acceptance rule **no** matter what means of communication he uses as long as the acceptance is sent on or before May 3.
   c. If Wax purports to accept the offer on April 15 at $50,000 and Knox refuses to sell at that price, Wax nevertheless has the right to accept at $75,000 by May 3.
   d. A telephone call by Wax to Knox on May 3, accepting the offer at $75,000, will effectively bind Knox.

12. Ted King, a building subcontractor, submitted a bid for construction of a portion of a high-rise office building. The bid contained material errors in computation. Lago Corp., the general contractor, accepted the bid with knowledge of King's errors. King
   a. Must perform the contract unless he can show that Lago acted fraudulently.
   b. Must perform the contract according to the stated terms since his errors were unilateral.
   c. Will avoid liability on the contract only if his errors were **not** due to his negligence.
   d. Will avoid liability on the contract since Lago knew of King's errors.

13. In determining whether the consideration requirement has been satisfied to form a contract, the courts will be required to decide whether the consideration
   a. Was bargained for.
   b. Was fair and adequate.
   c. Has sufficient economic value.
   d. Conforms to the subjective intent of the parties.

14. Ruehl purchased a service station business from Lull. The purchase price included payment for Lull's goodwill. The agreement contained a covenant prohibiting Lull from competing with Ruehl in the service station business. Which of the following statements regarding the covenant is **incorrect?**
   a. The value to be assigned to it is the excess of the price paid over the seller's cost of all tangible assets.
   b. The time period for which it is to be effective must be reasonable.
   c. The restraint must be **no** more extensive than is reasonably necessary to protect the goodwill purchased by Ruehl.
   d. The geographic area to which it applies must be reasonable.

15. John Tuck entered into a contract with Jack Doe. Doe asserts that he entered into the contract under duress. Which of the following best describes a necessary element of duress?

   a. There must have been a confidential or fiduciary relationship between Tuck and Doe.
   b. The contract entered into between Tuck and Doe was unconscionable.
   c. Doe entered into the contract with Tuck because of Tuck's improper threats.
   d. Tuck must have intended that Doe be influenced by the improper threats.

16. A written agreement was signed by both parties which was intended to be their entire agreement. The parol evidence rule will prevent the admission of evidence which is offered to

   a. Explain the meaning of an ambiguity in the written contract.
   b. Establish that fraud had been committed in the formation of the contract.
   c. Prove the existence of a contemporaneous oral agreement which modifies the contract.
   d. Prove the existence of a subsequent oral agreement which modifies the contract.

Items 17 and 18 are based on the following information:

Sand sold a warehouse he owned to Quick Corp. The warehouse was encumbered by an outstanding mortgage securing Sand's note to Security Bank. Quick assumed the Sand's note and mortgage at the time it purchased the warehouse from Sand. Within three months, Quick defaulted on the note and Security Bank commenced a mortgage foreclosure action. The proceeds of the resulting foreclosure sale were less than the outstanding balance on the note.

17. As to the contract between Sand and Quick, Security is

   a. A third party creditor beneficiary.
   b. A third party donee beneficiary.
   c. A third party incidental beneficiary.
   d. Not a beneficiary.

18. Which of the following statements is correct regarding the rights and liabilities of the parties?

   a. Quick's liability is limited to its equity in the warehouse.
   b. Sand remains liable on the note.
   c. Security must first proceed against Quick to recover the deficiency before seeking payment from Sand.
   d. Sand is **not** liable for the deficiency because Quick assumed the note and mortgage.

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19. Fiore owed Lutz $5,000. As the result of an unrelated transaction, Lutz owed Bing that same amount. The three parties signed an agreement that Fiore would pay Bing instead of Lutz and Lutz would be discharged from all liability. The agreement among the parties is

   a. Unenforceable for lack of consideration.
   b. Voidable at Bing's option.
   c. An executed accord and satisfaction.
   d. A novation.

20. Kemp entered into a contract to sell Ward a parcel of land. Kemp was aware that Ward was purchasing the land with the intention of building a high-rise office building. Kemp was also aware of the fact that a subsurface soil condition would prevent such construction. The condition was extremely unusual and not readily discoverable in the course of normal inspections or soil evaluations. Kemp did not disclose the existence of the condition to Ward, nor did Ward make any inquiry of Kemp as to the suitability of the land for his intended development. Kemp's silence as to the soil condition

   a. Renders the contract voidable at Ward's option.
   b. Renders the contract void.
   c. Will **not** affect the validity of the contract.
   d. Entitles Ward only to money damages.

21. Fred Gray, an employee of Gold Transport Corp., was injured when the corporate truck which he was driving struck a tree. The state in which Gold was incorporated and operated its business had a compulsory workers' compensation law. Gray will likely receive workers' compensation benefits despite the fact he

   a. Was properly excluded from coverage under the compulsory workers' compensation law.
   b. Was driving the truck outside the course of his employment at the time of the accident.
   c. Intentionally drove the truck into the tree.
   d. Was negligent by failing to adhere to Gold's safety procedures while operating the truck.

22. Jay White, an engineer, entered into a contract with Sky, Inc., agreeing to provide Sky with certain specified consulting services. After performing the services, White was paid pursuant to the contract but social security taxes were not withheld from his check since Sky considered White an independent contractor. The IRS has asserted that White was an employee and claims that a deficiency exists due to Sky's failure to withhold and pay social security taxes. Which of the following factors is most likely to support the IRS's position that White is an employee?

   a. White was paid in one lump sum after all the services were performed.
   b. White provided his own office and supplies.
   c. Sky supervised and controlled the manner in which White performed the services.
   d. Sky reserved the right to inspect White's work.

23. Which of the following agreements is **not** illegal per se but its legality or illegality is determined by the rule of reason under the antitrust laws?
   a. A vertical restraint contained in a franchise agreement between the manufacturer and retailer limiting the territory in which the retailer may sell.
   b. An agreement among a manufacturer and wholesalers to boycott a troublesome retailer who is selling below the manufacturer's suggested retail price.
   c. A horizontal restraint pursuant to an agreement among competitors to divide the market by geographic area.
   d. An agreement among competitors to limit the production of products in accordance with the consumer price index.

24. Fine Tools, Inc. has been charged with a violation of the provisions of the Federal Trade Commission Act section dealing with unfair methods of competition. The Federal Trade Commission Act
   a. Provides for exclusive remedies which can **not** be applied if there is another antitrust act under which to proceed.
   b. Applies exclusively to contracts for the sale or purchase of goods and commodities in interstate commerce.
   c. Permits the Federal Trade Commission to issue cease and desist orders in certain cases despite insufficient proof of a violation either under the Sherman or Clayton Acts.
   d. Authorizes the Federal Trade Commission to initiate and prosecute criminal actions against violators.

25. Sunk Corp. has been charged with a violation of the Robinson-Patman Act involving sales to its customers at different prices. In order to establish a prima facie case under the Robinson-Patman Act based on price discrimination it must be shown among other things that
   a. Sunk made sales of commodities of a like grade and quality to two or more customers.
   b. There was an actual and substantial lessening of competition which arose out of interstate commerce.
   c. A monopoly resulted from the alleged violation.
   d. Sunk profited from the alleged violation.

26. Lux Corp. has been suffering large losses for the past two years. Because of its inability to meet current obligations, Lux has filed a petition for reorganization under Chapter 11 of the Bankruptcy Code. The reorganization provisions under the Bankruptcy Code
   a. Require that the court appoint a trustee in all cases.
   b. Permit Lux to remain in possession of its assets.
   c. Apply only to involuntary bankruptcy.
   d. Will apply to Lux only if Lux is required to register pursuant to the federal securities laws.

27. Fox, a sole proprietor, has been involuntarily petitioned into bankruptcy under the liquidation provisions of the Bankruptcy Code. Sax, CPA, has been appointed trustee of the debtor's estate. If Sax also wishes to act as the tax return preparer for the estate, which of the following statements is correct?
   a. Sax may employ himself to prepare tax returns if authorized by the court and may receive a separate fee for services rendered in each capacity.
   b. Sax is prohibited from serving as both trustee and preparer under any circumstances since serving in that dual capacity would be a conflict of interest.
   c. Although Sax may serve as both trustee and preparer, he is entitled to receive a fee only for the services rendered as a preparer.
   d. Although Sax may serve as both trustee and preparer, his fee for services rendered in each capacity will be determined solely by the size of the estate.

28. Sly has serious financial problems and is unable to meet current unsecured obligations of $30,000 to 19 creditors who are demanding immediate payment. Sly owes Kane $6,500 and Kane has decided to file an involuntary petition in bankruptcy against Sly. Which of the following is necessary in order for Kane to validly petition Sly into bankruptcy?
   a. Kane must allege and establish that Sly's liabilities exceed the fair market value of Sly's assets.
   b. Kane must be joined by at least two other creditors.
   c. Sly must have committed an act of bankruptcy within 120 days of the filing.
   d. Kane must be a secured creditor.

29. A bankrupt who has voluntarily filed for and received a discharge in bankruptcy under the liquidation provisions (Ch. 7)
   a. Is precluded from owning or operating a similar business for two years.
   b. Must surrender for distribution to the creditors amounts received as an inheritance if the receipt occurs within 180 days after filing of the petition.
   c. Will receive a discharge of any and all debts owed by him as long as he has **not** committed a bankruptcy offense.
   d. Can obtain another voluntary discharge in bankruptcy under Ch. 7 after five years have elapsed from the date of the prior filing.

30. Which of the following will **not** be discharged in a bankruptcy proceeding?
   a. Claims resulting out of an extension of credit based upon false representations.
   b. Claims of secured creditors which remain unsatisfied after their receipt of the proceeds from the disposition of the collateral.
   c. Claims for unintentional torts which resulted in bodily injury to the claimant.
   d. Claims arising out of the breach of a contract by the debtor.

31. Frost borrowed $120,000 as additional working capital for his business from Safe Bank. Safe required that the loan be collateralized to the extent of 50%, and an acceptable surety for the entire amount be obtained. Thrift Surety Co. agreed to act as surety on the loan and Frost pledged $60,000 of negotiable bearer bonds, which belonged to his wife, with Safe. Frost has defaulted. Which of the following is correct?
   a. Safe must first proceed against Frost and obtain a judgment for payment before it can proceed against the collateral.
   b. As a result of the default, Thrift and Frost's wife are co-sureties.
   c. Thrift is liable in full immediately upon default by Frost, but will upon satisfaction of the debt be entitled to the collateral.
   d. Safe must first liquidate the collateral before it can proceed against Thrift.

32. West promised to make Noll a loan of $180,000 if Noll obtained sureties to secure the loan. Noll entered into an agreement with Carr, Gray, and Pine to act as co-sureties on his loan from West. The agreement between Noll and the co-sureties provided for compensation to be paid to each of the co-sureties. It further indicated that the maximum liability of each co-surety would be as follows: Carr $180,000, Gray $60,000, and Pine $120,000. West accepted the commitment of the sureties and made the loan to Noll. After paying nine installments totaling $90,000, Noll defaulted. Gray's debts (including his surety obligation to West on the Noll loan) were discharged in bankruptcy. Subsequently, Carr properly paid the entire debt outstanding of $90,000. What amounts may Carr recover from the co-sureties?

	Gray	*Pine*
a.	$0	$30,000
b.	$0	$36,000
c.	$15,000	$30,000
d.	$30,000	$30,000

33. Which of the following transfers by a retailer of men's clothing is subject to the Bulk Transfers Article of the UCC?
   a. A transfer of substantially all of its merchandise in the ordinary course of its business.
   b. A transfer of its entire accounts receivable.
   c. A transfer of substantially all of its equipment and merchandise outside the ordinary course of business.
   d. A pledge of a substantial portion of its inventory to secure a working capital loan.

Items 34 and 35 are based on the following information:

Queen Corp. has decided to sell its retail hardware business to Major for $90,000. Pursuant to the sales agreement, Queen transferred all of its inventory and equipment to Major. Within 45 days thereafter, Major transferred a portion of the inventory to Price. At the time of the sale, Queen owed Johnson Co. $10,000 for previous purchases of inventory.

34. If all other requirements of the Bulk Transfers Article are complied with, the transfer from Queen to Major will be effective against Johnson despite
   a. Major's failure to file a list of creditors with the Attorney General and Secretary of State within 30 days after the transfer.
   b. Major's failure to require Queen to furnish a list of Queen's existing creditors.
   c. Major's knowledge that the list of creditors prepared by Queen omitted Johnson.
   d. Major's failure to give proper notice of the transfer at least ten days before it took possession of the inventory and equipment or paid for them, whichever occurred first.

35. If Queen and Major failed to prepare a schedule of the property transferred, Price will
   a. Nevertheless receive title to the inventory free of the claim of Johnson under all circumstances.
   b. Take title subject to the claim of Johnson if Price received the inventory from Major as a gift.
   c. Always take free of the claim of Johnson if he gives value.
   d. Receive a voidable title permitting Major at its option to set aside the transfer to Price.

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36. An instrument complies with the requirements for negotiability contained in the UCC Article on Commercial Paper. The instrument contains language expressly acknowledging the receipt of $40,000 by Mint Bank and an agreement to repay principal with interest at 11% six months from date. The instrument is

a. A banker's acceptance.
b. A banker's draft.
c. A negotiable certificate of deposit.
d. Nonnegotiable because of the additional language.

37. Jane Lane, a sole proprietor, has in her possession several checks which she received from her customers. Lane is concerned about the safety of the checks since she believes that many of them are bearer paper which may be cashed without endorsement. The checks in Lane's possession will be considered order paper rather than bearer paper if they were made payable (in the drawer's handwriting) to the order of

a. Cash.
b. Ted Tint, and endorsed by Ted Tint in blank.
c. Bearer, and endorsed by Ken Kent making them payable to Jane Lane.
d. Bearer, and endorsed by Sam Sole in blank.

38. The requirements for an instrument to qualify as negotiable commercial paper

a. May be waived by a separate agreement signed by the original parties to the instrument as long as the variations are fair and voluntarily agreed upon.
b. Prohibit substitutions or variances from the exact language of the UCC.
c. May be satisfied by the insertion of a clause in the instrument indicating that the instrument is negotiable.
d. Must be satisfied at least in principle, although the exact language set forth in the UCC may be varied.

39. John Daly received a check which was originally made payable to the order of one of his customers, Al Pine. The following endorsement was written on the back of the check:

> Al Pine, without recourse, for collection only

The endorsement on this check would be classified as

a. Blank, unqualified, and non-restrictive.
b. Blank, qualified, and restrictive.
c. Special, unqualified, and restrictive.
d. Special, qualified, and non-restrictive.

40. Below is a note which your client Best Realtors obtained from Green in connection with Green's purchase of land located in Rye, N.Y. The note was given for the balance due on the purchase and was secured by a first mortgage on the land.

> $90,000.00 Rye, N.Y.
> May 1, 1985
>
> For value received, six years after date, I promise to pay to the order of Best Realtors NINETY THOUSAND and 00/100 DOLLARS with interest at 16% compounded annually until fully paid. This instrument arises out of the sale of land located in N.Y. and the law of N.Y. is to be applied to any question which may arise. It is secured by a first mortgage on the land conveyed. It is further agreed that:
>
> 1. Purchaser will pay the costs of collection including attorney's fees upon default.
> 2. Purchaser may repay the amount outstanding on any anniversary date of this note.
>
> *Ted Green*
> Ted Green

This note is a

a. Negotiable promissory note.
b. Negotiable investment security under the UCC.
c. Nonnegotiable promissory note since it is secured by a first mortgage.
d. Nonnegotiable promissory note since it permits prepayment and requires the maker's payment of the costs of collection and attorney's fees.

41. Hunt has in his possession a negotiable instrument which was originally payable to the order of Carr. It was transferred to Hunt by a mere delivery by Drake, who took it from Carr in good faith in satisfaction of an antecedent debt. The back of the instrument read as follows, "Pay to the order of Drake in satisfaction of my prior purchase of a new video calculator, signed Carr." Which of the following is correct?

a. Hunt has the right to assert Drake's rights, including his standing as a holder in due course and also has the right to obtain Drake's signature.
b. Drake's taking the instrument for an antecedent debt prevents him from qualifying as a holder in due course.
c. Carr's endorsement was a special endorsement; thus Drake's signature was not required in order to negotiate it.
d. Hunt is a holder in due course.

42. Frey paid Holt $2,500 by check pursuant to an agreement between them whereby Holt promised to perform in Frey's theater within the next year. Holt endorsed the check, making it payable to Len Able. Holt's status with regard to the check was one of a(n)

a. Assignee since a payee may **not** also be a holder in due course.
b. Holder since Holt's promise failed to satisfy the value requirement necessary to become a holder in due course.
c. Holder in due course under the shelter rule since Able's rights as a holder in due course revert to Holt.
d. Holder in due course since all the requirements have been satisfied.

43. Blue is a holder of a check which was originally drawn by Rush and made payable to Silk. Silk properly endorsed the check to Field. Field had the check certified by the drawee bank and then endorsed the check to Blue. As a result

a. Field is discharged from liability.
b. Rush alone is discharged from liability.
c. The drawee bank becomes primarily liable and both Silk and Rush are discharged.
d. Rush is secondarily liable.

44. Ore Corp. sold 10 tons of steel to Bay Corp. with payment to be by Bay's check. Since the price of steel was fluctuating daily, Ore requested that the amount of Bay's check be left blank and it would fill in the current market price. Bay complied with Ore's request. Within two days Ore received Bay's check. Although the market price of 10 tons of steel at the time Ore received Bay's check was $40,000, Ore filled in the check for $50,000 and negotiated it to Cam Corp. Cam took the check in good faith, without notice of Ore's act or any other defense, and in payment of an antecedent debt. Bay will

a. Be liable to Cam for $50,000.
b. Be liable to Cam but only for $40,000.
c. Not be liable to Cam since the check was materially altered by Ore.
d. Not be liable to Cam since Cam failed to give value when it acquired the check from Ore.

45. Bell Co. owned 20 engines which it deposited in a public warehouse on May 5, receiving a negotiable warehouse receipt in its name. Bell sold the engines to Spark Corp. On which of the following dates did the risk of loss transfer from Bell to Spark?

a. June 11 — Spark signed a contract to buy the engines from Bell for $19,000. Delivery was to be at the warehouse.
b. June 12 — Spark paid for the engines.
c. June 13 — Bell negotiated the warehouse receipt to Spark.
d. June 14 — Spark received delivery of the engines at the warehouse.

46. Which of the following terms generally must be included in a writing which would otherwise satisfy the UCC statute of frauds regarding the sale of goods?

a. The warranties to be granted.
b. The price of the goods.
c. The designation of the parties as buyer and seller.
d. The quantity of the goods.

47. Dill purchased a computer from Park, who regularly sells computers to the general public. After receiving payment in full, Park tendered delivery of the computer to Dill. Rather than take immediate delivery, Dill stated that he would return later that day to pick up the computer. Before Dill returned, thieves entered Park's store and stole Dill's computer. The risk of loss

a. Remained with Park since title had **not** yet passed to Dill.
b. Remained with Park since Dill had **not** yet received the computer.
c. Passed to Dill upon Park's tender of delivery.
d. Passed to Dill at the time the contract was formed and payment was made.

48. Kirk Corp. sold Nix an Ajax freezer, Model 24, for $490. The contract required delivery to be made by June 23. On June 12, Kirk delivered an Ajax freezer, Model 52, to Nix. Nix immediately notified Kirk that the wrong freezer had been delivered and indicated that the delivery of a correct freezer would not be acceptable. Kirk wishes to deliver an Ajax freezer, Model 24 on June 23. Which of the following statements is correct?

a. Kirk may deliver the freezer on June 23 without further notice to Nix.
b. Kirk may deliver the freezer on June 23 if it first seasonably notifies Nix of its intent to do so.
c. Nix must accept the non-conforming freezer but may recover damages.
d. Nix always may reject the non-conforming freezer and refuse delivery of a conforming freezer on June 23.

49. A typewriter, which was subject to a prior UCC security interest, was delivered to Ed Fogel for repair. Fogel is engaged in the business of repairing typewriters. Fogel repaired the typewriter. However, the owner of the typewriter now refuses to pay for the services performed by Fogel. The state in which Fogel operates his business has a statute which gives Fogel a mechanics lien on the typewriter. Fogel's mechanics lien

a. Takes priority over a prior perfected security interest under all circumstances.
b. Is subject to a prior perfected purchase money security interest under all circumstances.
c. Is subject to a prior unperfected security interest where the statute is silent as to priority.
d. Takes priority over a prior perfected security interest unless the statute expressly provides otherwise.

50. Under the UCC, collateral which has been sold in a private sale by a secured party to a good faith purchaser for value after the debtor's default
  a. May be redeemed by the debtor within 10 days after the disposition.
  b. May be redeemed by creditors with subordinate claims.
  c. Remains subject to the security interests of subordinate lien creditors in all cases where the collateral is disposed of at a private sale.
  d. Discharges the security interest pursuant to which such sale was made and any security interest or lien subordinate thereto.

Items 51 and 52 are based on the following information:

Mini, Inc., entered into a five-year lease with Rein Realtors. The lease was signed by both parties and immediately recorded. The leased building was to be used by Mini in connection with its business operations. To make it suitable for that purpose, Mini attached a piece of equipment to the wall of the building.

51. Which of the following is most important in determining whether the equipment became a fixture?
  a. Whether the equipment can be removed without material damage to the building.
  b. Whether the attachment is customary for the type of building.
  c. The fair market value of the equipment at the time the lease expires.
  d. The fact that the equipment was subject to depreciation.

52. Which of the following statements is correct regarding Mini's rights and liabilities?
  a. Mini is prohibited from assigning the lease if it is silent in this regard.
  b. Mini has a possessory interest in the building.
  c. Mini is strictly liable for all injuries sustained by any person in the building during the term of the lease.
  d. Mini's rights under the lease are automatically terminated by Rein's sale of the building to a third party.

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53. Jane and her brother each own a ½ interest in certain real property as tenants in common. Jane's interest
  a. Is considered personal property.
  b. Will pass to her brother by operation of law upon Jane's death.
  c. Will pass upon her death to the person Jane designates in her will.
  d. May **not** be transferred during Jane's lifetime without her brother's consent.

54. Real estate title insurance
  a. May be transferred to a subsequent bona fide purchaser for value.
  b. Assures that the purchaser will take title free and clear of all defects.
  c. Assures that the purchaser will take title free and clear of all record defects since all exceptions to title must be cleared prior to the purchaser taking posssession of the realty.
  d. Is generally **not** required where the contract is silent on this point.

Items 55 and 56 are based on the following information:

On June 1, 1985, Byrd Corp. purchased a high-rise building from Slade Corp. for $375,000. The building was encumbered by a mortgage and note dated May 1, 1980 executed by Slade. The mortgage had been duly recorded by the mortgagee, Fale Bank. The outstanding balance on the mortgage at the time of Byrd's purchase was $300,000. Byrd acquired the property subject to the mortgage held by Fale and, in addition, gave a mortgage on the building to Foxx Finance to secure a non-purchase money promissory note in the sum of $50,000. Prior to any payments being made on either loan, Byrd defaulted. As a result, the building was properly sold at a foreclosure sale for $280,000.

55. Which of the following statements is correct regarding Byrd's and Slade's liability to Fale?
  a. Byrd is liable to Fale for any deficiency.
  b. Byrd is secondarily liable to Fale as a surety.
  c. Slade was automatically released from all liability to Fale upon Byrd's acquisition of the building subject to the mortgage.
  d. Slade is liable to Fale for any resulting deficiency.

56. As a result of the foreclosure sale
  a. Fale is entitled to receive the full $280,000 out of the proceeds.
  b. Fale is entitled to receive $240,000 out of the proceeds.
  c. Foxx is entitled to receive its full $50,000 from either Byrd or Slade.
  d. Foxx is entitled to receive $50,000 out of the proceeds.

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57. Farr obtained a $45,000 loan from State Bank, executing a promissory note and mortgage. The loan was secured by a factory which Farr purchased from Datz for $79,000. State's recording of the mortgage

a. Cuts off the rights of all prior and subsequent lessees of the factory.
b. Transfers legal title to the factory to State.
c. Generally creates a possessory security interest in State.
d. Generally does **not** affect the rights of Farr and State against each other under the promissory note.

58. A distinguishing feature between the making of an intervivos gift and the creation of a trust is that

a. A gift may be made orally whereas a trust must be in a signed writing.
b. Generally, a gift is irrevocable whereas a trust may be revoked in certain cases.
c. In order to create a valid trust, the creator must receive some form of consideration.
d. The beneficiary of a trust must be notified of the trust's creation.

59. The coinsurance feature of property insurance

a. Prevents the insured from insuring for a minimal amount and recovering in full for such losses.
b. Precludes the insured from insuring for less than the coinsurance percentage.
c. Is an additional refinement of the insurable interest requirement.
d. Is fixed at a minimum of 80% by law.

60. West is seeking to collect on a property insurance policy covering certain described property which was destroyed. The insurer has denied recovery based upon West's alleged lack of an insurable interest in the property. In which of the situations described below will the insurance company prevail?

a. West is **not** the owner of the insured property but a mere long-term lessee.
b. The insured property belongs to a general trade debtor of West and the debt is unsecured.
c. The insured property does **not** belong to West, but instead to a corporation which he controls.
d. The property has been willed to West's father for life and, upon his father's death, to West as the remainderman.

Number 2 (Estimated time —— 15 to 20 minutes)

Mason & Dilworth, CPAs, were the accountants for Monrad Corporation, a closely held corporation. Mason & Dilworth had been previously engaged by Monrad to perform certain compilation and tax return work. Crass, Monrad's president, indicated he needed something more than the previous type of services rendered. He advised Walker, the partner in charge, that the financial statements would be used internally, primarily for management purposes, and also to obtain short-term loans from financial institutions. Walker recommended that a review of the financial statements be performed. Walker did not prepare an engagement letter.

In the course of the review, Walker indicated some reservations about the financial statements. Walker indicated at various stages that "he was uneasy about certain figures and conclusions" but that "he would take the client's word about the validity of certain entries since the review was primarily for internal use in any event and was not an audit."

Mason & Dilworth did not discover a material act of fraud committed by management. The fraud would have been detected had Walker not relied wholly on the representations of management concerning the validity of certain entries about which he had felt uneasy.

Required: Answer the following, setting forth reasons for any conclusions stated.

a. What is the role of the engagement letter when a CPA has agreed to perform a review of a closely held company? What points should be covered in a typical engagement letter which would be relevant to the parties under the facts set forth above?

b. What is the duty of the CPA in the event suspicious circumstances are revealed as a result of the review?

c. What potential liability does Mason & Dilworth face and who may assert claims against the firm?

Number 3 (Estimated time —— 15 to 20 minutes)

John Nolan, a partner in Nolan, Stein, & Wolf partnership, transferred his interest in the partnership to Simon and withdrew from the partnership. Although the partnership will continue, Stein and Wolf have refused to admit Simon as a partner.

Subsequently, the partnership appointed Ed Lemon as its agent to market its various product lines. Lemon entered into a two-year written agency contract with the partnership which provided that Lemon would receive a 10% sales commission. The agency contract was signed by Lemon and, on behalf of the partnership, by Stein and Wolf.

After six months, Lemon was terminated without cause. Lemon asserts that:

- He is an agent coupled with an interest.
- The agency relationship may not be terminated without cause prior to the expiration of its term.
- He is entitled to damages because of the termination of the agency relationship.

Required: Answer the following, setting forth reasons for any conclusions stated.

a. Discuss Nolan's property rights in the partnership prior to his withdrawal and the property rights acquired by Simon as a result of his transaction with Nolan.

b. Discuss the merits of Lemon's assertions.

Number 4 (Estimated time —— 15 to 20 minutes)

John Barr purchased a new fork-lift for use in his business from Fiber Corp. Fiber designs, manufactures, and assembles fork-lifts, shipping them directly to customers throughout the U.S. The contract between Barr and Fiber contained a clause in fine print disclaiming "all warranties express or implied other than the limited warranty provided for on the face of this contract." The limited warranty included in the contract provided that "the buyer's sole and exclusive remedy shall be repair or replacement of defective parts and the seller shall not be liable for damages or personal injuries." The contract was a standard form used by Fiber, and as a matter of policy Fiber does not negotiate the terms and conditions of the contract with its customers.

Within one week of the purchase date, Barr was seriously injured when the steering wheel locked causing him to lose control of the fork-lift. Barr brings an action against Fiber for the personal injuries that he sustained based on the following causes of action:

- Negligence
- Breach of warranty
- Strict liability in tort

Fiber has asserted that the action brought by Barr should be dismissed due to the disclaimer.

Required: Answer the following, setting forth reasons for any conclusions stated.

a. Discuss in separate paragraphs the prerequisites necessary to sustain each of the three causes of action asserted by Barr.

b. Discuss the validity of the disclaimer with regard to the breach of warranty cause of action.

Number 5 (Estimated time —— 15 to 20 minutes)

One of your firm's clients, Fancy Fashions, Inc., is a highly successful, rapidly expanding company. The company is owned predominantly by the Munn family and key corporate officers. Although additional funds would be available on a short-term basis from its bankers, this would only represent a short-term solution to the company's need for capital to fund its expansion plans. In addition, the interest rates being charged are not appealing. Therefore, John Munn, Fancy's chairman of the board, in consultation with the other shareholders, has decided to explore raising additional equity capital of approximately \$4.5 to \$5 million which will provide the funds necessary to continue the growth and expansion of the company. This will be Fancy's first offering to persons other than the Munn family and key management personnel.

At a meeting of Fancy's major shareholders, its attorneys and a CPA from your firm, the advantages and disadvantages of "going public" and registering an offering of its stock were discussed. One of the participants suggested that Regulation D under the Securities Act of 1933 might be a preferable alternative.

Required: Answer the following, setting forth reasons for any conclusions stated.

a. What are the elements or factors which will determine whether Fancy's offering is required to be registered pursuant to the provisions of the Securities Act of 1933?

b. Assume there is a public offering for \$4.5 million and, as a result, more than 500 persons own shares of Fancy. What implications, if any, will these facts have in respect to the Securities Exchange Act of 1934?

c. What federal civil and criminal liabilities may apply in the event that Fancy sells the securities without a registration and an exemption to registration is not available?

d. Discuss the exemption applicable to offerings of up to \$5 million (under Rule 505 of Regulation D) in terms of:

1. What are the two kinds of and the number of investors who may participate?
2. Are audited financial statements required?
3. What restrictions apply to the manner or way the securities may be sold?

EXAMINATION IN ACCOUNTING THEORY

(Theory of Accounts)

November 8, 1985; 1:30 to 5:00 P.M.

NOTE TO CANDIDATES: Suggested time allotments are as follows:

All questions are required:	*Estimated Minutes* *Minimum*	*Maximum*
No. 1	90	110
No. 2	15	25
No. 3	15	25
No. 4	15	25
No. 5	15	25
Total	150	210

INSTRUCTIONS TO CANDIDATES

(Disregard of these instructions may be considered as indicating inefficiency in accounting work.)

1. You must arrange the papers in numerical order of the questions. If more than one page is required for an answer, write "continued" at the bottom of the page. Number pages consecutively. For instance, if 12 pages are used for your answers, the objective answer sheet is page 1 and your other pages should be numbered 2 through 12.

2. Answer **all** objective-type items on the printed answer sheet provided for that purpose. It is to your advantage to attempt all questions even if you are uncertain of the answer. You are likely to get the highest score if you omit no answers. Since objective items are computer-graded, your comments and calculations associated with them are not considered. Be certain that you have entered your answers on the objective answer sheet before the examination time is up.

3. A CPA is continually confronted with the necessity of expressing opinions and conclusions in written reports in clear, unequivocal language. Although the primary purpose of the examination is to test the candidate's knowledge and application of the subject matter, the ability to organize and present such knowledge in acceptable written language will be considered by the examiners.

Prepared by the Board of Examiners of the American Institute of Certified Public Accountants and adopted by the examining boards of all states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands of the United States.

Number 1 (Estimated time —— 90 to 110 minutes)

Instructions

Select the **best** answer for each of the following items relating to **a variety of issues in accounting.** Use a soft pencil, preferably No. 2, to blacken the appropriate circle on the separate printed answer sheet to indicate your answer. **Mark only one answer for each item. Answer all items.** Your grade will be based on the total number of your correct answers.

The following is an example of the manner in which the answer sheet should be marked:

Item

99. The financial statement which summarizes the financial position of a company is the
   a. Income statement.
   b. Balance sheet.
   c. Statement of changes in financial position.
   d. Retained earnings statement.

Answer Sheet

99. ⓐ ● ⓒ ⓓ

Items to be Answered

1. Under Statements of Financial Accounting Concepts, which of the following relates to both relevance and reliability?
   a. Timeliness.
   b. Neutrality.
   c. Feedback value.
   d. Consistency.

2. Under Statements of Financial Accounting Concepts, comprehensive income includes which of the following?

	Gains	*Gross margin*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

3. When the allowance method of recognizing bad debt expense is used, the entry to record the specific write-off of an uncollectible account would decrease
   a. Net accounts receivable.
   b. Allowance for doubtful accounts.
   c. Net income.
   d. Working capital.

4. When computing purchasing power gains or losses, how is each of the following classified?

	Allowance for doubtful accounts	*Obligations under warranties*
a.	Monetary	Nonmonetary
b.	Monetary	Monetary
c.	Nonmonetary	Monetary
d.	Nonmonetary	Nonmonetary

5. At its inception, the lease term of Lease G is 65% of the estimated remaining economic life of the leased property. This lease contains a bargain purchase option. The lessee should record Lease G as
   a. Neither an asset **nor** a liability.
   b. An asset but **not** a liability.
   c. An asset and a liability.
   d. An expense.

6. For a lease that transfers ownership of the property to the lessee by the end of the lease term, the lessee should
   a. Record the minimum lease payment as an expense.
   b. Amortize the capitalizable cost of the property using the interest method.
   c. Amortize the capitalizable cost of the property in a manner consistent with the lessee's normal depreciation policy for owned assets except that the period of amortization should be the lease term.
   d. Amortize the capitalizable cost of the property in a manner consistent with the lessee's normal depreciation policy for owned assets.

7. Which of the following should be expensed as incurred by the franchisee for a franchise with an estimated useful life of ten years?
   a. Amount paid to the franchisor for the franchise.
   b. Periodic payments to a company, other than the franchisor, for that company's franchise.
   c. Legal fees paid to the franchisee's lawyers to obtain the franchise.
   d. Periodic payments to the franchisor based on the franchisee's revenues.

8. The premium on a three-year insurance policy expiring on December 31, 1985, was paid in total on January 1, 1983. Assuming that the original payment was initially debited to an expense account, and that appropriate adjusting entries have been recorded on December 31, 1983, and 1984, the balance in the prepaid asset account on December 31, 1984, would be
   a. Zero.
   b. Lower than the balance on December 31, 1985.
   c. The same as the original payment.
   d. The same as it would have been if the original payment had been initially debited to a prepaid asset account.

9. Magazine subscriptions collected in advance are reported as
   a. A contra account to magazine subscriptions receivable in the asset section of the balance sheet.
   b. Deferred revenue in the liability section of the balance sheet.
   c. Deferred revenue in the stockholders' equity section of the balance sheet.
   d. Magazine subscription revenue in the income statement in the period collected.

10. A machine was purchased in 1984. The straight-line depreciation method with a half-year's depreciation taken in the first year, was used for financial statement purposes and was less than the accelerated cost recovery system deduction taken for income tax purposes. Assume that the company is profitable, there are and have been no other timing differences, and the effective income tax rate is 40%. In the December 31, 1984, balance sheet, a noncurrent deferred income tax credit would be reported in the amount of
   a. 40% of the excess of the accelerated cost recovery system deduction over the straight-line depreciation method expense.
   b. 40% of the excess of the straight-line depreciation method expense over the accelerated cost recovery system deduction.
   c. 60% of the excess of the accelerated cost recovery system deduction over the straight-line depreciation method expense.
   d. 60% of the excess of the straight-line depreciation method expense over the accelerated cost recovery system deduction.

11. The lessee's balance sheet liability for a capital lease would be periodically reduced by the total
   a. Minimum lease payment plus the amortization of the related asset.
   b. Minimum lease payment less the amortization of the related asset.
   c. Minimum lease payment less the portion of the minimum lease payment allocable to interest.
   d. Minimum lease payment.

12. Theoretically, the proceeds from the sale of a bond will be equal to
   a. The sum of the face amount of the bond and the periodic interest payments.
   b. The face amount of the bond.
   c. The face amount of the bond plus the present value of the interest payments made during the life of the bond discounted at the prevailing market rate of interest.
   d. The present value of the principal amount due at the end of the life of the bond plus the present value of the interest payments made during the life of the bond, each discounted at the prevailing market rate of interest.

13. When outstanding bonds are converted into common stock, the carrying value of the bonds payable would be removed from the accounts when using the

	Book value method	*Market value method*
a.	Yes	Yes
b.	Yes	No
c.	No	No
d.	No	Yes

14. A portion of the proceeds should be allocated to paid-in capital for bonds issued with

	Detachable stock purchase warrants	*Nondetachable stock purchase warrants*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

15. A 10-year bond was issued in 1982 at a premium with a call provision to retire the bonds. When the bond issuer exercised the call provision on an interest date in 1985, the call price exceeded the carrying value of the bonds. The amount of bond liability removed from the accounts in 1985 should have equaled the
   a. Cash paid.
   b. Face amount plus unamortized premium.
   c. Call price plus unamortized premium.
   d. Current market price.

16. An activity that would be expensed currently as research and development costs is the
   a. Engineering follow-through in an early phase of commercial production.
   b. Conceptual formulation and design of possible product or process alternatives.
   c. Adaptation of an existing capability to a particular requirement or customer's need as part of a continuing commercial activity.
   d. Trouble-shooting in connection with breakdowns during commercial production.

17. When the allowance method of recognizing bad debt expense is used, the entries at the time of collection of a small account previously written off would
   a. Decrease the allowance for doubtful accounts.
   b. Increase net income.
   c. Have **no** effect on the allowance for doubtful accounts.
   d. Have **no** effect on net income.

18. The pension expense accrued by a company will be increased by interest equivalents when
   a. Amounts funded are greater than pension cost accrued.
   b. Amounts funded are less than pension cost accrued.
   c. The plan is fully vested.
   d. The plan is fully funded.

19. Which of the following contingencies should generally be accrued on the balance sheet when the occurrence of the contingent event is reasonably possible and its amount can be reasonably estimated?

	Gain contingency	*Loss contingency*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

20. Realized gains from the sale of marketable equity securities should be included in net income of the period of sale when the marketable equity securities portfolio of which they are a part is classified as

	Current	*Noncurrent*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

21. Gains resulting from the process of translating a foreign entity's financial statements from the functional currency, which has **not** experienced significant inflation, to U.S. dollars should be included as a (an)

a. Separate component of stockholders' equity.
b. Deferred credit.
c. Component of income from continuing operations.
d. Extraordinary item.

22. The deferred method of tax allocation should be followed for

	Interperiod income tax allocation	*Intraperiod income tax allocation*
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

23. The cumulative effect of a change in accounting principle on the amount of retained earnings at the beginning of the period in which the change is made should be reported separately as a component of income after continuing operations for a change from the

a. Double-declining-balance method of depreciation for previously recorded assets to the straight-line method.
b. LIFO method of inventory pricing to the FIFO method.
c. Completed-contract method of accounting for long-term construction-type contracts to the percentage-of-completion method.
d. Percentage-of-completion method of accounting for long-term construction-type contracts to the completed-contract method.

24. A transaction that is unusual in nature and infrequent in occurrence should be reported separately as a component of income

a. Before cumulative effect of accounting changes and after discontinued operations of a segment of a business.
b. Before cumulative effect of accounting changes and before discontinued operations of a segment of a business.
c. After cumulative effect of accounting changes and after discontinued operations of a segment of a business.
d. After cumulative effect of accounting changes and before discontinued operations of a segment of a business.

25. In computing earnings per share, a method of recognizing the use of proceeds that would be obtained upon exercise of options and warrants is the

a. Antidilution method.
b. Common stock equivalents method.
c. Treasury stock method.
d. If-converted method.

26. The retirement of long-term debt by the issuance of common stock should be presented in a statement of changes in financial position as a

	Source of funds	*Use of funds*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

27. The amortization of bond premium on long-term debt should be presented in a statement of changes in financial position as a (an)

a. Use of funds.
b. Source and a use of funds.
c. Addition to income from continuing operations.
d. Deduction from income from continuing operations.

28. In accounting for a long-term construction contract using the percentage-of-completion method, the progress billings on contracts account is a

a. Contra current asset account.
b. Contra noncurrent asset account.
c. Noncurrent liability account.
d. Revenue account.

29. For an employer's defined benefit pension plan, the actuarial present value of nonvested accumulated plan benefits should be

a. Both an accrual and a disclosure.
b. A disclosure, but **not** an accrual.
c. An accrual, but **not** a disclosure.
d. Neither an accrual **nor** a disclosure.

30. Which of the following should be disclosed in the Summary of Significant Accounting Policies?

	Basis of consolidation	*Composition of plant assets*
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

31. A change in the periods benefitted by a deferred cost because additional information has been obtained is
   a. An accounting change that should be reported in the period of change and future periods if the change affects both.
   b. An accounting change that should be reported by restating the financial statements of all prior periods presented.
   c. A correction of an error.
   d. Not an accounting change.

32. Registration fees related to effecting a business combination should be deducted in determining net income of the combined corporation for the period in which the fees were incurred for a

	Pooling of interests	*Purchase*
a.	No	Yes
b.	No	No
c.	Yes	No
d.	Yes	Yes

33. In financial reporting for segments of a business enterprise, the operating profit or loss of a segment should include

	Expenses related to revenue from intersegment sales	*Portion of general corporate expenses*
a.	Yes	Yes
b.	Yes	No
c.	No	No
d.	No	Yes

34. A development stage enterprise should include with its financial statements certain additional information. Cumulative amounts from the enterprise's inception is an example of additional information that should be included in its

	Income statement	*Statement of changes in financial position*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

35. How are trade receivables used in the calculation of each of the following?

	Acid test (quick) ratio	*Receivable turnover*
a.	Numerator	Numerator
b.	Numerator	Denominator
c.	Denominator	Denominator
d.	Not used	Numerator

36. In developing a factory overhead application rate for use in a process costing system, which of the following could be used in the numerator?
   a. Actual direct labor hours.
   b. Estimated direct labor hours.
   c. Actual factory overhead costs.
   d. Estimated factory overhead costs.

37. The cost of rent for a manufacturing plant is a

	Prime cost	*Product cost*
a.	No	Yes
b.	No	No
c.	Yes	No
d.	Yes	Yes

38. In a job order cost system, the application of factory overhead would usually be reflected in the general ledger as an increase in
   a. Factory overhead control.
   b. Finished goods control.
   c. Work in process control.
   d. Cost of goods sold.

39. Assuming that there was no beginning work in process inventory, and the ending work in process inventory is 50% complete as to conversion costs, the number of equivalent units as to conversion costs would be
   a. The same as the units completed.
   b. The same as the units placed in process.
   c. Less than the units completed.
   d. Less than the units placed in process.

40. Under the three-variance method for analyzing factory overhead, which of the following is used in the computation of the spending variance?

	Budget allowance based on standard hours	*Factory overhead applied to production*
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

41. Under the two-variance method for analyzing factory overhead, the difference between the actual factory overhead and the factory overhead applied to production is the
   a. Controllable variance.
   b. Net overhead variance.
   c. Efficiency variance.
   d. Volume variance.

42. Actual sales values at the split-off point for joint products Y and Z are not known. However, for purposes of allocating joint costs to products Y and Z the relative sales value at split-off method is used. An increase in the costs beyond split-off for product Z occurs, while those of product Y remain constant. If the selling prices of finished products Y and Z remain constant, the percentage of the total joint costs allocated to Product Y and Product Z would
   a. Decrease for Product Y and Product Z.
   b. Decrease for Product Y and increase for Product Z.
   c. Increase for Product Y and decrease for Product Z.
   d. Increase for Product Y and Product Z.

43. The absorption costing method includes in inventory

	Fixed factory overhead	*Variable factory overhead*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

44. An internal report for a decentralized organization reports transfers between segments. For this internal report, transfer prices charged for a product with a determinable market price would usually be based on
   a. Cost or market, whichever is lower.
   b. Market price.
   c. Historical cost.
   d. Variable cost.

45. When a flexible budget is used, an increase in production levels within a relevant range would
   a. Not change fixed costs per unit.
   b. Change total fixed costs.
   c. Not change variable costs per unit.
   d. Not change total variable costs.

46. Breakeven analysis assumes over the relevant range that
   a. Total costs are unchanged.
   b. Selling prices are unchanged.
   c. Variable costs are nonlinear.
   d. Fixed costs are nonlinear.

47. The discount rate (hurdle rate of return) must be determined in advance for the
   a. Internal rate of return method.
   b. Net present value method.
   c. Payback period method.
   d. Time adjusted rate of return method.

48. The payback capital budgeting technique considers

	Income over entire life of project	*Time value of money*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

49. A company's return on investment is affected by a change in

	Capital turnover	*Profit margin on sales*
a.	Yes	Yes
b.	Yes	No
c.	No	No
d.	No	Yes

50. In probability analysis, the square root of the mean of the squared differences between the observed values and the expected value is the
   a. Objective function.
   b. Optimum corner point.
   c. EOQ.
   d. Standard deviation.

51. Under which basis of accounting for a governmental unit should revenues be recognized in the accounting period in which they are earned and become measurable?

	Accrual basis	*Modified accrual basis*
a.	No	No
b.	No	Yes
c.	Yes	Yes
d.	Yes	No

52. The estimated revenues control account of a governmental unit is debited when
   a. The budget is closed out at the end of the year.
   b. The budget is recorded.
   c. Actual revenues are recorded.
   d. Actual revenues are collected.

53. When a truck is received by a governmental unit, the truck should be recorded in the general fund as a debit to a(an)
   a. Appropriations control.
   b. Encumbrances control.
   c. Fixed asset.
   d. Expenditures control.

54. Which of the following funds of a governmental unit uses the modified accrual basis of accounting?
   a. Internal service.
   b. Enterprise.
   c. Nonexpendable trust.
   d. Debt service.

55. Proceeds of General Obligation Bonds is an account of a governmental unit that would be included in the
   a. Enterprise fund.
   b. Special assessments fund.
   c. Capital projects fund.
   d. Debt service fund.

56. Which of the following funds of a governmental unit would include contributed capital in its balance sheet?
   a. Expendable pension trust.
   b. Special revenue.
   c. Capital projects.
   d. Internal service.

57. The Amount Available in Debt Service Funds is an account of a governmental unit that would be included in the
   a. Liability section of the debt service fund.
   b. Liability section of the general long-term debt account group.
   c. Asset section of the debt service fund.
   d. Asset section of the general long-term debt account group.

58. The comprehensive annual financial report (CAFR) of a governmental unit should contain a combined statement of revenues, expenditures, and changes in fund balances for

	Governmental funds	*Account groups*
a.	Yes	Yes
b.	Yes	No
c.	No	No
d.	No	Yes

59. A voluntary health and welfare organization received a cash donation in 1983 from a donor specifying that the amount donated be used in 1985. The cash donation should be accounted for as
   a. Support in 1983.
   b. Support in 1983, 1984, and 1985, and as a deferred credit in the balance sheet at the end of 1983 and 1984.
   c. Support in 1985, and **no** deferred credit in the balance sheet at the end of 1983 and 1984.
   d. Support in 1985, and as a deferred credit in the balance sheet at the end of 1983 and 1984.

60. The property, plant, and equipment of a not-for-profit hospital should be accounted for as part of
   a. Unrestricted funds.
   b. Restricted funds.
   c. Specific purpose funds.
   d. Other nonoperating funds.

Number 2 (Estimated time —— 15 to 25 minutes)

Gehl Company purchased significant amounts of new equipment this year to be used in its operations. The equipment was delivered by the suppliers, installed by Gehl, and placed into operation. Some of it was purchased for cash with discounts available for prompt payment. Some of it was purchased under long-term payment plans for which the interest charges approximate prevailing rates. As a result, Gehl is studying its capitalization and depreciation policies.

Required:

a. What costs should Gehl capitalize for the new equipment purchased this year?

b. What factors cause the equipment to lose its future economic benefit?

c. What factors should be considered in computing the equipment's depreciation expense?

d. What theoretical justifications are there for the use of accelerated depreciation methods?

Number 3 (Estimated time —— 15 to 25 minutes)

Caddell Company, a wholesaler, purchases its inventories from various suppliers FOB destination; it incurs substantial warehousing costs. Caddell uses the dollar value LIFO inventory cost flow method. Caddell also consigns some of its inventories to Reed Company.

Reed also has items for sale that it purchases from other wholesalers. Reed uses the lower of FIFO cost or market inventory method.

Required:

a. When should the purchases from various suppliers generally be included in Caddell's inventory? Why?

b. Theoretically, how should Caddell account for the warehousing costs? Why?

c. 1. What are the advantages of using the dollar value LIFO inventory cost flow method as opposed to the conventional quantity of goods LIFO method?

2. How does the calculation of dollar value LIFO differ from the conventional quantity of goods method?

d. How should Caddell account for the inventories consigned to Reed Company? Why?

e. When Reed applies the lower of cost or market method, what are the ceiling and floor limits?

Number 4 (Estimated time —— 15 to 25 minutes)

Walker Company has a noncurrent marketable equity securities portfolio. Walker does not own more than five percent of the outstanding voting stock for any of the securities in the portfolio. At the beginning of the year, the aggregate market value of the portfolio exceeded its cost. Cash dividends on these securities were received during the year. None of the securities in the portfolio were sold during the year. At the end of the year, the aggregate cost of the portfolio exceeded its market value. The decline in the market price of the securities in the portfolio is attributable to general market decline.

During the year, Walker purchased for cash thirty-five percent of the outstanding voting stock of Sipe Company. Cash dividends on this investment were received from Sipe during the year, and the earnings of Sipe after the acquisition date were reported by Sipe to Walker.

Required:

a. How should Walker report on its balance sheet and income statement the effects of its investment in the noncurrent marketable equity securities portfolio for the year? Why?

b. How should Walker report on its balance sheet and income statement the effects of its investment in Sipe for the year? Why?

Number 5 (Estimated time —— 15 to 25 minutes)

Brady Company has 30,000 shares of $10 par value common stock authorized and 20,000 shares issued and outstanding. On August 15, 1984, Brady purchased 1,000 shares of treasury stock for $12 per share. Brady uses the cost method to account for treasury stock. On September 14, 1984, Brady sold 500 shares of the treasury stock for $14 per share.

In October 1984, Brady declared and distributed 2,000 shares as a stock dividend from unissued shares when the market value of the common stock was $16 per share.

On December 20, 1984, Brady declared a $1 per share cash dividend, payable on January 10, 1985, to shareholders of record on December 31, 1984.

Required:

a. How should Brady account for the purchase and sale of the treasury stock, and how should the treasury stock be presented in Brady's balance sheet at December 31, 1984?

b. How should Brady account for the stock dividend, and how would it affect Brady's stockholders' equity at December 31, 1984? Why?

c. How should Brady account for the cash dividend, and how would it affect Brady's balance sheet at December 31, 1984? Why?

ANSWERS TO EXAMINATION

ACCOUNTING PRACTICE — PART I

November 6, 1985; 1:30 to 6:00 P.M.

Answer 1 (10 points)

1. c
2. d
3. c
4. b
5. b
6. b
7. b
8. c
9. c
10. a
11. a
12. d
13. d
14. c
15. b
16. d
17. c
18. c
19. b
20. a

Answer 2 (10 points)

21. a
22. d
23. b
24. c
25. a
26. b
27. a
28. d
29. b
30. a
31. c
32. b
33. d
34. d
35. a
36. d
37. c
38. b
39. b
40. c

Answer 3 (10 points)

41. d
42. a
43. b
44. d
45. a
46. c
47. b
48. a
49. b
50. d
51. c
52. a
53. c
54. c
55. d
56. c
57. d
58. a
59. b
60. a

The scores for the multiple choice questions were determined in accordance with the following scales:

Answer 1

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	½	1	1½	2	2½	3	3½	4	4½	5	5½	6	6½	7	7½	8	8½	9	9½	10

Answer 2

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	1	1½	2	2½	3	3½	4	4½	5	5½	6	6½	7	7½	8	8½	9	9½	10	10

Answer 3

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	1½	2	2½	3	3½	4	4½	5	5½	6	6½	7	7½	8	8½	9	9½	10	10	10

Answer 4 (10 points)

a.

Munn, Inc.

SCHEDULE OF EXPENSES RELATING TO OTHER NONCURRENT ASSETS

For the Year Ended December 31, 1984

Amortization of intangibles		
Patent	$ 28,000	[1]
Trademark	15,000	[2]
Non-competition agreement	40,000	[3]
Total	$ 83,000	
Consulting fee to Cody Corporation	$ 50,000	
Deferred income tax expense	$ 2,000	[4]

b.

Munn, Inc.

OTHER NONCURRENT ASSETS SECTION OF BALANCE SHEET

December 31, 1984

Investment in bonds	$ 929,150	[5]
Patent, net of accumulated amortization of $52,000	140,000	[6]
Trademark, net of accumulated amortization of $15,000	585,000	[7]
Non-competition agreement, net of accumulated amortization of $40,000	160,000	[8]
Deferred income tax charges	34,000	[9]
Total other noncurrent assets	$1,848,150	

Answer 4 (continued)

Explanations of Amounts

[1]	Amortization of patent		
	Patent balance, 12/31/83 ($192,000 − $24,000)	$ 168,000	
	Life of patent (6 years from 12/31/83)	÷ 6	
	Amortization for 1984	$ 28,000	
[2]	Amortization of trademark		
	Cost of trademark, 1/3/84 ($800,000 × ¾)	$ 600,000	
	Life of trademark (maximum 40 years)	÷ 40	
	Amortization for 1984	$ 15,000	
[3]	Amortization of non-competition agreement		
	Cost of non-competition agreement, 1/3/84 ($800,000 × ¼)	$ 200,000	
	Life of agreement (5 years)	÷ 5	
	Amortization for 1984	$ 40,000	
[4]	Deferred income tax expense		
	Timing differences for 1984		
	Excess of book rent income over tax rent income of $20,000 × 40%	$ 8,000	
	Deduct excess of book warranty expense over tax warranty deduction of $15,000 × 40%	6,000	
	Net expense for 1984	$ 2,000	
[5]	Investment in bonds		
	Cost of bonds, 7/1/84	$ 923,000	
	Add amortization of discount from 7/1 to 12/31/84 ($46,150 − $40,000)	6,150	
	Balance, 12/31/84	$ 929,150	
[6]	Patent, net of accumulated amortization		
	Cost of patent, 1/1/82	$ 192,000	
	Deduct accumulated amortization, 12/31/83	24,000	
	Patent balance, 12/31/83	$ 168,000	
	Deduct amortization for 1984	28,000	[1]
	Balance, 12/31/84	$ 140,000	
[7]	Trademark, net of accumulated amortization		
	Cost of trademark, 1/3/84	$ 600,000	[2]
	Deduct amortization for 1984	$ 15,000	[2]
	Balance, 12/31/84	$ 585,000	
[8]	Non-competition agreement, net of accumulated amortization		
	Cost of non-competition agreement, 1/3/84	$ 200,000	[3]
	Deduct amortization for 1984	40,000	[3]
	Balance, 12/31/84	$ 160,000	
[9]	Deferred income tax charges		
	Balance, 12/31/83	$ 36,000	
	Deduct charge to expense for 1984	2,000	[4]
	Balance, 12/31/84	$ 34,000	

Answer 5 (10 points)

Case, Inc. and Subsidiary
CONSOLIDATED BALANCE SHEET WORKSHEET
December 31, 1984

a.

			Adjustments & Eliminations		
	Case, Inc.	*Frey, Inc.*	*Debit*	*Credit*	*Consolidated*
Assets:					
Cash	$ 825,000	$ 330,000			$ 1,155,000
Accounts & other receivables	2,140,000	835,000		[3]$ 8,000	2,247,000
				[4] 720,000	
Inventories	2,310,000	1,045,000		[5] 90,000	3,265,000
Land	650,000	300,000			950,000
Depreciable assets, net	4,575,000	1,980,000			6,555,000
Investment in Frey, Inc.	2,430,000			[1] 2,430,000	
Long-term investments & other assets	865,000	385,000		[2] 320,000	930,000
	$13,795,000	$4,875,000			$15,102,000
Liabilities and Stockholders' Equity:					
Accounts payable & other current liabilities	$ 2,465,000	$1,145,000	[3]$ 8,000		$ 2,882,000
			[4] 720,000		
Long-term debt	1,900,000	1,300,000	[2] 320,000		2,880,000
Common stock, $25 par	3,200,000	1,000,000	[1] 1,000,000		3,200,000
Additional paid-in capital	1,850,000	190,000	[1] 190,000		1,850,000
Retained earnings	4,380,000	1,240,000	[1] 1,240,000		4,290,000
			[5] 90,000		
	$13,795,000	$4,875,000	$3,568,000	$3,568,000	$15,102,000

Answer 5 (continued)

b. *Case, Inc. and Subsidiary*
CONSOLIDATED STATEMENT OF RETAINED EARNINGS
For the Year Ended December 31, 1984

Balance, December 31, 1983:		
As originally reported	$2,506,000	
Adjustment for pooling of interests with Frey, Inc.	820,000	
As restated	3,326,000	
Net income	1,380,000	[6]
	4,706,000	
Deduct cash dividends paid:		
By Frey, Inc., prior to combination	160,000	[7]
By Case, Inc., after the combination	256,000	
	416,000	
Balance, December 31, 1984	$4,290,000	

Explanations of Worksheet Entries & Other Amounts

[1] To eliminate the reciprocal elements in investment and equity accounts.

[2] To eliminate Case's investment in Frey's bonds.

[3] To eliminate Case's intercompany accrued interest receivable on its investment in Frey's bonds for the period 10/1 — 12/31/84. ($320,000 × 10% × ¼ = $8,000)

[4] To eliminate Case's intercompany balance for merchandise owed by Frey.

[5] To eliminate intercompany profit in ending inventory of Frey. ($180,000 × ½ = $90,000)

[6] Consolidated net income for 1984

Case, Inc.	$ 890,000	
Frey, Inc.	580,000	
	$1,470,000	
Deduct intercompany profit in inventory	90,000	[5]
	$1,380,000	

[7] Dividend paid 6/15/84 [40,000 shares × $4] $ 160,000

ANSWERS TO EXAMINATION

ACCOUNTING PRACTICE — PART II

November 7, 1985; 1:30 to 6:00 P.M.

Answer 1 (10 points)

1. c
2. a
3. b
4. c
5. a
6. c
7. a
8. a
9. d
10. c
11. b
12. c
13. c
14. b
15. a
16. b
17. b
18. c
19. c
20. a

Answer 2 (10 points)

21. a
22. d
23. c
24. d
25. a
26. b
27. a
28. d
29. c
30. d
31. b
32. a
33. d
34. d
35. a
36. d
37. c
38. c
39. a
40. b

Answer 3 (10 points)

41. d
42. b
43. c
44. b
45. c
46. d
47. a
48. b
49. c
50. a
51. a
52. c
53. b
54. d
55. d
56. a
57. b
58. c
59. b
60. d

The scores for the multiple choice questions were determined in accordance with the following scales:

Answer 1

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	1	1½	2	2½	3	3½	4	4½	5	5½	6	6½	7	7½	8	8½	9	9½	10	10

Answer 2

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	½	1	1½	2	2½	3	3½	4	4½	5	5½	6	6½	7	7½	8	8½	9	9½	10

Answer 3

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	½	1	1½	2	2½	3	3½	4	4½	5	5½	6	6½	7	7½	8	8½	9	9½	10

Answer 4 (10 points)

Dorn Foundation
STATEMENT OF CHANGES IN FINANCIAL POSITION
For the Year Ended June 30, 1985

Financial resources were provided by	
Excess of revenues over expenses before capital additions	$128,000
Capital additions	60,000
Excess of revenues over expenses after capital additions	188,000
Add expenses not requiring current outlay of working capital — depreciation and amortization	148,000
Working capital provided by operations and capital additions	336,000
Financial resources were used for	
Acquisition of property, plant, and equipment	22,000
Reduction of noncurrent capital lease obligations	176,000
Increase in noncurrent investments and endowment fund cash	60,000
Total resources used	258,000
Increase in working capital	$ 78,000

Changes in working capital were represented by	
Increase in current assets	
Cash	$ 20,000
Accounts receivable	32,000
Unbilled contract revenues and reimbursable grant expenses	196,000
Prepaid expenses	4,000
Total increase in current assets	252,000
(Increase) in current liabilities	
Accounts payable	(60,000)
Restricted grant advances	(102,000)
Obligations under capital leases	(12,000)
Total (increase) in current liabilities	(174,000)
Increase in working capital	$ 78,000

Answer 5 (10 points)

a.

Leif Company
Sigma Division

SCHEDULE OF EXPECTED ANNUAL CONTRIBUTION MARGIN FOR KACE AT VARIOUS SALES PRICES

Sales price	*Expected sales level (units)*	*Expected total sales*	*Expected variable costs at $3*	*Expected contribution margin*
$6	83,000 [1]	$498,000	$249,000	$249,000
7	79,000 [2]	553,000	237,000	316,000
8	74,000 [3]	592,000	222,000	370,000

[1] 70,000 × 10% = 7,000	[2] 70,000 × 40% = 28,000	[3] 70,000 × 70% = 49,000
80,000 × 50% = 40,000	80,000 × 30% = 24,000	80,000 × 20% = 16,000
90,000 × 40% = 36,000	90,000 × 30% = 27,000	90,000 × 10% = 9,000
83,000	79,000	74,000

b.

1. COMPUTATION OF CURRENT PRE-TAX ACCOUNTING RATE OF RETURN ON INVESTMENT

Sigma Division's current annual sales	$2,000,000	
Current pre-tax rate of return on sales	10%	$200,000
Investment in Sigma Division		600,000
Pre-tax accounting rate of return on investment		33⅓%

b.

2. COMPUTATION OF EXPECTED PRE-TAX ACCOUNTING RATE OF RETURN ON IMPLEMENTATION OF RECOMMENDATIONS BY MANAGER OF SIGMA DIVISION

Sigma Division's current annual sales	$2,000,000	
Expected reduction in sales volume (10%)	200,000	
Expected sales volume after discontinuance of Sago	1,800,000	
Expected pre-tax accounting rate of return on sales	12%	$216,000
Total proposed investment in Sigma Division		700,000
Expected pre-tax accounting rate of return on investment		30.86%

c. COMPUTATION OF NET PRESENT VALUE OF INVESTMENT OPPORTUNITY ON PROPOSED LOAN TO COTE CORP.

Discounted cash flows for year:		
1	.8 × $ 50,000 =	$ 40,000
2	.7 × 90,000 =	63,000
3	.6 × 110,000 =	66,000
Total		$169,000
Proposed loan		200,000
Net present value		$(31,000)

This investment will not earn an internal rate of return of 20%.

ANSWERS TO EXAMINATION

AUDITING

November 7, 1985; 8:30 A.M. to 12:00 M.

Answer 1 (60 points)

1. c	11. a	21. c	31. a	41. b	51. d
2. c	12. a	22. d	32. d	42. b	52. d
3. d	13. c	23. d	33. a	43. b	53. a
4. b	14. a	24. b	34. c	44. a	54. c
5. d	15. b	25. c	35. d	45. d	55. c
6. a	16. c	26. b	36. d	46. b	56. a
7. d	17. c	27. c	37. a	47. d	57. a
8. d	18. b	28. c	38. d	48. a	58. b
9. a	19. c	29. c	39. b	49. b	59. d
10. b	20. a	30. b	40. b	50. b	60. d

The scores for the multiple choice questions were determined in accordance with the following scale:

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23

Correct	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40
Score	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43

Correct	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60
Score	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	60	60	60

Answer 2 (10 points)

a. In order for May & Marty to satisfy itself about the independence and professional reputation of Dey & Dee and assure itself that there has been coordination of activities between the two auditors in order to achieve a proper review of matters affecting consolidation, May & Marty, whether or not it makes reference to Dey & Dee's examination, should consider performing the following procedures:

- Make inquiries about the professional reputation and standing of Dey & Dee to one or more of the following:
  - AICPA, applicable state society of CPAs, and/or local chapter.
  - Other appropriate sources such as other practitioners, bankers, and other credit grantors.
- Obtain a representation from Dey & Dee that it is independent under the requirements of the AICPA and, if appropriate, the requirements of the SEC.
- Ascertain through communication with Dey & Dee that
  - Dey & Dee is aware that the BGI-Western financial statements are to be included in the BGI consolidated financial statements on which May & Marty will report, and that Dey & Dee's report will be relied upon by May & Marty.
  - Dey & Dee is familiar with GAAP and GAAS and will conduct its examination in accordance therewith.
  - Dey & Dee has knowledge of the relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies such as the SEC, if appropriate.
  - A review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among components included in the financial statements.

b. May & Marty could adopt the position of not making reference to Dey & Dee's examination of BGI-Western if May & Marty is able to satisfy itself about the independence and professional reputation of Dey & Dee and takes steps it considers appropriate to satisfy itself as to Dey & Dee's examination of BGI-Western. Ordinarily, May & Marty would be able to adopt the position of not making reference to Dey & Dee's examination when any one of the following conditions exists:

- Dey & Dee is an associate or correspondent firm and its work is acceptable to May & Marty based on May & Marty's knowledge of the professional standards and competence of Dey & Dee; or
- Dey & Dee is retained by May & Marty and the work is performed under May & Marty's guidance and control; or
- May & Marty takes steps it considers necessary to satisfy itself as to Dey & Dee's examination. Such steps may include a visit to Dey and Dee to discuss Dey and Dee's audit procedures or a review of Dey and Dee's audit programs and/or working papers. In addition, May and Marty is satisfied about the reasonableness of the statements of BGI-Western for purposes of inclusion in BGI's consolidated financial statements; or
- BGI-Western's financial statements are not a material part of BGI's consolidated financial statements.

Answer 3 (10 points)

To the Board of Trustees of
Modern Museum, Inc.

We have examined the statements of assets, liabilities, and fund balances (modified cash basis) of Modern Museum, Inc., as of December 31, 1984 and 1983, and the related statements of support, revenue, and expenses and of changes in fund balances (modified cash basis) and changes in financial resources (modified cash basis) for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note X, the organization's policy is to prepare its financial statements on the basis of cash receipts and disbursements, except that they include provision for depreciation of buildings and equipment. Consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the assets, liabilities, and fund balances of Modern Museum, Inc., at December 31, 1984 and 1983, and its support, revenue, and expenses and the changes in its fund balances and changes in financial resources for the years then ended, on the basis of accounting described in Note X, which has been applied on a consistent basis.

Brown & Brown, CPAs

March 12, 1985

Answer 4 (10 points)

a. Since recipients of negative accounts receivable confirmations are requested to respond only if they disagree with the information in the confirmation, no additional audit procedures are necessary on nonresponses to negative accounts receivable confirmations.

For nonresponses to positive confirmations, Wright should consider performing the following alternative audit procedures:

- The use of other means, e.g., telephone inquiry, of directly communicating with the debtor.
- Examination of evidence of subsequent cash receipts.
- Examination of evidence of customer orders, duplicate sales invoices, and shipping documents.
- Examination of William's files involving correspondence with the customers.

b. The other matters that Wright would expect to be included in William's management representation letter are whether or not

- Management acknowledges responsibility for the fair presentation in the financial statements of financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles (or other comprehensive basis of accounting).
- All financial records and data were made available.
- The accountant has been furnished with copies of all minutes of meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies).
- The company has satisfactory title to all owned assets, and whether there are liens or encumbrances on such assets or any pledging of assets.
- Provision, when material, has been made to reduce excess or obsolete inventories to their estimated net realizable value.
- There are related party transactions or related party receivables or payables that have not been properly disclosed in the financial statements.
- There are compensating balance or other arrangements involving restrictions on cash balances.
- Unasserted claims or assessments that management's counsel has advised are probable of assertion have been disclosed in accordance with Statement of Financial Accounting Standards No. 5.
- There are other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.

Answer 5 (10 points)

XY Company's major internal accounting control weaknesses are:

Purchasing:

- The buyer does not verify that the department head's request is within budget limitations.
- No procedures have been established to assure that the best price is obtained. Large dollar requisitions should be ordered after receiving quotes and/or sealed bids.
- Prior to placing an order, the buyer does not determine the adequacy of the vendor's past record as a supplier to XY.

Receiving:

- Receiving clerk does not make blind counts for all special equipment or at least for large dollar items.
- Written notice of equipment received is not sent to purchasing.
- Written notice of equipment received is not sent to accounts payable.

Accounts Payable:

- The mathematical accuracy of the invoice is not recomputed.
- Invoice quantity is not compared with a report of quantity received.
- Notification of the acceptability of the equipment from the requisitioning department is not obtained before the payable is recorded.
- No alphabetic file of vendors from whom purchases are made is maintained.

Treasurer:

- Documentation supporting the checks is not sent by the accounts payable department to the cashier in order for the cashier or treasurer to be assured that the check is for properly authorized and received equipment.
- Checks for large dollar purchases are not signed by two officers of XY Company to assure that material expenditures are proper.
- All documentation to support a check is not canceled by the check-signer and returned to the accounts payable department.
- The cashier alone has custody of the key, the signature plate, and record of usage.
- The controller is authorized to sign checks.

ANSWERS TO EXAMINATION

BUSINESS LAW

(Commercial Law)

November 8, 1985; 8:30 A.M. to 12:00 M.

Answer 1 (60 points)

1. b	11. d	21. d	31. c	41. a	51. a
2. d	12. d	22. c	32. b	42. b	52. b
3. c	13. a	23. a	33. c	43. c	53. c
4. d	14. a	24. c	34. a	44. a	54. d
5. a	15. c	25. a	35. b	45. c	55. d
6. c	16. c	26. b	36. c	46. d	56. a
7. d	17. a	27. a	37. c	47. b	57. d
8. c	18. b	28. b	38. d	48. b	58. b
9. d	19. d	29. b	39. b	49. d	59. a
10. c	20. a	30. a	40. a	50. d	60. b

The scores for the multiple choice questions were determined in accordance with the following scale:

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25

Correct	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40
Score	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45

Correct	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60
Score	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	60	60	60	60	60

Answer 2 (10 points)

a. The role of the engagement letter is to set forth in writing the nature and limitations of the engagement and define the arrangement between the CPA and his client. The engagement letter should clearly and precisely state the type of engagement contemplated and the scope of such an undertaking. It should indicate the procedures and steps to be taken in the review and indicate the tests that will be performed. It should also state that the engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcation, but the CPA will inform his client of any such matters that come to his attention. The engagement letter or an acknowledgement should be signed by the client. If the engagement letter is carefully prepared and if it spells out the engagement clearly, it will play an important role if a dispute arises between the CPA and his client. The engagement letter will also help the courts to avoid any misunderstanding about the scope of the engagement.

b. Under such circumstances, the courts that have considered the question and SSARS No. 1 promulgated by the AICPA both impose a duty of inquiry when the CPA becomes aware of suspicious circumstances. Certainly, the mere reliance upon management's word is not sufficient. The facts indicated that Walker was "uneasy about certain figures and conclusions." The CPA has an obvious duty to the client, Monrad, to inquire into any suspicious circumstances of which he becomes aware.

c. Depending on the circumstances about who in management was involved and their ownership of stock, Monrad in its own right may bring an action or the shareholders may bring a derivative action against Mason & Dilworth on behalf of the corporation for negligently failing to detect the fraud. It is possible that an action based upon constructive fraud might also be asserted against the firm because the conduct might be categorized as gross negligence or a reckless disregard for the truth. Certainly, a shareholder in his own right and any of the lending institutions will assert this and privity of contract will not be a valid defense.

There is authority supporting the rights of third party plaintiffs to sue and to recover from the accountants based upon a negligently performed review. As a general rule, third parties, even though not parties to the contract, may successfully assert negligence if they can show that they are members of a class of persons intended to benefit from the services performed by the CPA and that this was reasonably forseeable by the CPA.

Answer 3 (10 points)

a. Nolan's property rights in the partnership prior to the conveyance of his partnership interest consisted of:

- His rights in specific partnership property. This right permitted Nolan to possess any item of partnership property for partnership purposes.
- His interest in the partnership. This interest is classified as personal property and is defined as the partner's share of the profits and surplus (including capital).
- His right to participate in the management of the partnership. This right entitles Nolan to an equal voice in the management and conduct of the partnership business.

Nolan's transfer of his partnership interest to Simon merely entitles Simon to receive Nolan's share of the profits and Nolan's interest in any property distributed by the partnership. Since Stein and Wolf have refused to admit Simon as a partner, Simon will not be entitled to participate in the management of the partnership or to acquire Nolan's right to possess specific partnership property.

b. Lemon's first assertion that he is an agent coupled with an interest is incorrect. An agency coupled with an interest in the subject matter arises when the agent has an interest in the property that is the subject of the agency. The fact that Lemon entered into a two-year written agency agreement with the partnership that would pay Lemon a commission clearly will not establish an interest in the subject matter of the agency. The mere expectation of profits to be realized or proceeds to be derived from the sale of the partnership's products is not sufficient to create an agency coupled with an interest. As a result, the principal-agency relationship may be terminated at any time.

Lemon's second assertion that the principal-agency relationship may not be terminated without cause prior to the expiration of its term is incorrect. Where a principal-agency relationship is based upon a contract to engage the agent for a specified period of time, the principal may discharge the agent despite the fact such discharge is wrongful. Although the principal does not have the right to discharge the agent, he does have the power to do so. Thus, Lemon may be discharged without cause.

Lemon's third assertion that he is entitled to damages because of the termination of the agency relationship is correct. Where a principal wrongfully discharges its agent, the principal is liable for damages based on breach of contract. Under the facts, Lemon's discharge by the partnership without cause constitutes a breach of contract for which Lemon may recover damages.

Answer 4 (10 points)

a. *Negligence.* In order to establish a cause of action based on negligence Barr must establish the following elements:

- That the defendant owed a legal duty to the plaintiff.
- That the defendant breached that duty.
- That the plaintiff sustained an actual loss or damages.
- That the breach of duty was the proximate cause of the plaintiff's actual loss or damages.

In determining if negligence is present the court will consider whether the defendant acted as a reasonably prudent person under the circumstances. Included in the reasonably prudent person test is whether the risk of harm was foreseeable.

Breach of Warranty. Since the sale of goods (the fork-lift) is involved in the contract, the UCC Sales Article applies. Because the seller would be regarded as a merchant, an implied warranty of merchantability is created. In order to establish a breach of this warranty, the plaintiff (Barr) must show:

- That the fork-lift was not fit for the ordinary purposes intended and

- That as a result of the breach of warranty, the plaintiff sustained a loss.

Strict Liability in Tort. Generally, the elements necessary to establish a cause of action based on strict liability in tort are as follows:

- That the product was in defective condition when it left the possession or control of the seller.
- That the product was unreasonably dangerous to the consumer or user.
- That the cause of the consumer's or user's injury was the defect.
- That the seller engaged in the business of selling such a product.
- That the product was one which the seller expected to and did reach the consumer or user without substantial changes in the condition in which it was sold.

Proof of fault is not a requirement to establish a cause of action in strict liability.

b. A proper disclaimer will permit the seller to exclude the implied warranty of merchantability. Under the facts, the disclaimer would appear to be invalid since a written disclaimer of the implied warranty of mechantability must be conspicuous and, arguably, the language in the contract is not acceptable under the UCC. In this case the disclaimer was in fine print and therefore not conspicuous. In addition, the disclaimer may be considered unconscionable since the contract was standardized and no bargaining of the terms of the contract was permitted. It should be pointed out that although consequential damages may be limited or excluded, in the case of consumer goods limitation of consequential damages for personal injuries is prima facie unconscionable. However, since the facts do not relate to consumer goods, such limitation of damages is not prima facie unconscionable but may be proved to be unconscionable.

Answer 5 (10 points)

a. There are four elements or factors to be considered in determining whether an offering of securities is subject to the registration requirements of the Securities Act of 1933. These are:

- The use of interstate commerce, e.g., the mails, in connection with the offer to sell or the sale of securities.
- The offering of said securities is to the "public".
- The offering or sale is made by an issuer, controlling person, or "statutory" underwriter.
- There is no relevant exemption available.

b. Since the sale of equity securities results in more than 500 persons owning Fancy stock, coupled with the fact that Fancy will have more than $3 million of assets, the corporation will be subjected to the full application of the Securities Exchange Act of 1934. As such, it will be required to register pursuant to the Act and thereby become subject to the Act's reporting, insider trading, proxy, and other requirements.

c. The Securities Act of 1933 provides that where there is a violation of the Act as a result of the failure to file a registration statement, the parties responsible shall be liable upon tender of the securities purchased for the amount paid, plus interest, less any distributions received. Damages are recoverable even if the party no longer owns the securities. Criminal penalties of a fine or imprisonment or both are applicable to any person who willfully violates the Securities Act of 1933.

d. An offering pursuant to Regulation D is exempt from registration. Regulation D is intended to permit exemption from registration of limited offers and sales by small businesses in need of capital.

1. There are two kinds of investors under Rule 505 of Regulation D: accredited investors as defined in the Regulation and all others who are designated as non-accredited investors. An unlimited number of accredited investors is permitted, but a maximum of 35 non-accredited investors is permitted.
2. Under Rule 505, if non-accredited investors are involved and Fancy is a non-reporting company under the Securities Exchange Act of 1934, it must supply audited financial statements for one year. If an audit of the most recent year would involve unreasonable effort or expense, an audited balance sheet only, dated within 120 days of the start of the offering, is permitted.
3. Rule 505 prohibits any general solicitation or general advertising of the securities within a 12-month period.

ANSWERS TO EXAMINATION

ACCOUNTING THEORY

(Theory of Accounts)

November 8, 1985; 1:30 P.M. to 5:00 P.M.

Answer 1 (60 points)

1. d	11. c	21. a	31. a	41. b	51. d
2. d	12. d	22. a	32. c	42. c	52. b
3. b	13. a	23. a	33. b	43. c	53. d
4. a	14. d	24. a	34. c	44. b	54. d
5. c	15. b	25. c	35. b	45. c	55. c
6. d	16. b	26. d	36. d	46. b	56. d
7. d	17. d	27. d	37. a	47. b	57. d
8. d	18. b	28. a	38. c	48. a	58. b
9. b	19. d	29. b	39. d	49. a	59. d
10. a	20. b	30. c	40. d	50. d	60. a

The score for the multiple choice question was determined in accordance with the following scale:

Correct	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Score	0	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26

Correct	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40
Score	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46

Correct	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60
Score	47	48	49	50	51	52	53	54	55	56	57	58	59	60	60	60	60	60	60	60

Answer 2 (10 points)

a. The costs that should be capitalized when equipment is purchased for cash should include the gross invoice price of the equipment less discount plus all incidental costs relating to its purchase or preparation for use. Any available discounts whether taken or not should be deducted from the gross invoice price of the equipment.

For equipment purchased under a long-term payment plan, the amount capitalized is the same as for equipment purchased for cash, i.e., the capitalizable cost represents the cash equivalent price. The interest charges should not be capitalized.

b. The physical factors that cause the equipment to depreciate are wear and tear from operation, action of time and other elements, and deterioration and decay. The functional factors that cause the equipment to depreciate are inadequacy, obsolescence, and supersession.

c. The factors that should be considered in computing depreciation expense are the cost of the asset, the estimated residual (salvage) value, and the allocation over the estimated service life of the asset by a systematic and rational allocation procedure.

d. Accelerated depreciation methods are justified based on the following assumptions:

- An asset is more efficient in the earlier years of its estimated useful life. Therefore, larger depreciation charges in the earlier years would be matched against the larger revenues generated in the earlier years.
- Repair expenses on an asset increase in the later years of its estimated useful life. Therefore, smaller depreciation charges in the later years would be combined with the larger repair expenses incurred in the later years resulting in a smooth or level pattern of these expenses.

Answer 3 (10 points)

a. Purchases from various suppliers should generally be included in Caddell's inventory when Caddell receives the goods. For accounting purposes, in the absence of other information, title to goods purchased FOB destination is assumed to pass when the goods are received.

b. Caddell should account for the warehousing costs as additional cost of inventory. Theoretically, warehousing is a cost of readying the goods for sale and should be included in inventory cost.

c. 1. The advantages of using the dollar value LIFO inventory cost flow method are to reduce the cost of accounting for inventory according to the LIFO method and to minimize the probability of unintentional liquidation of LIFO inventory.

2. The calculation of dollar value LIFO is based on dollars of inventory, a specific price index for each year, and broad inventory pools, whereas the conventional quantity of goods method is applied to individual units of each separate product. The inventory layers are identified with the price index for the year in which the layer was added.

d. Caddell should account for the inventories consigned to Reed Company as part of inventory. Caddell retains title to the goods until their sale by Reed; therefore, the earnings process has not been completed.

e. In applying the lower of cost or market method, market should not exceed the ceiling or fall below the floor. The ceiling is equal to the net realizable value, i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal. The floor is equal to the net realizable value reduced by an allowance for an approximately normal profit margin.

Answer 4 (10 points)

a. A noncurrent marketable equity securities portfolio should be accounted for at cost or market, whichever is lower. Therefore, at the end of the year Walker should report the noncurrent marketable equity securities portfolio as a noncurrent asset at market. It is conservative to carry the portfolio at market value when it is below cost because of the uncertainty of future recovery of the market decline. The amount by which the aggregate cost of the portfolio exceeded the market value at the end of the year should be accounted for as a valuation allowance to the portfolio. The offsetting portion of the entry is included in the equity section of the balance sheet and shown separately. The rationale for this treatment is that a decline in market value of an equity security classified as a noncurrent asset can be viewed as temporary and thus is not reflected in net income because the probability of realization of the loss is small.

Walker should report the cash dividends received during the year on the securities in the noncurrent marketable equity securities portfolio as dividend income.

b. Due to the size of its investment, i.e., over twenty percent of the outstanding voting stock of Sipe, Walker is presumed to be able to exercise significant influence over Sipe. Therefore, Walker should use the equity method of accounting for its investment in Sipe.

Walker should report the purchase of the stock of Sipe as a long-term investment, and initially account for it at cost, which is the amount of cash paid. The cash dividends received during the year by Walker on the investment in the stock of Sipe should be deducted from the carrying amount of the investment and have no effect on Walker's income statement.

Subsequent to the acquisition, Walker should report thirty-five percent of Sipe's earnings after the acquisition date as revenue in its income statement and add the same amount to the carrying amount of its investment on the balance sheet. This amount should be modified by adjustments similar to those made in preparing consolidated statements, including adjustments to eliminate intercompany gains and losses, and to amortize, if appropriate, any difference between Walker's cost and the underlying equity in net assets of Sipe on the acquisition date.

Answer 5 (10 points)

a. Brady should account for the purchase of the treasury stock on August 15, 1984, by debiting treasury stock and crediting cash for the cost of the purchase (1,000 shares × \$12 per share). Brady should account for the sale of the treasury stock on September 14, 1984, by debiting cash for the selling price (500 shares × \$14 per share), crediting treasury stock for cost (500 shares × \$12 per share), and crediting additional paid-in capital from treasury stock transactions for the excess of the selling price over the cost (500 shares × \$2 per share). The remaining treasury stock (500 shares × \$12 per share) should be presented separately in the stockholders' equity section of Brady's December 31, 1984, balance sheet as an unallocated reduction of stockholders' equity. These shares are considered issued but not part of common stock outstanding.

b. Brady should account for the stock dividend by debiting retained earnings for \$16 per share (the market value of the stock in October 1984, the date of the stock dividend) multiplied by the 2,000 shares distributed. Brady should then credit common stock for the par value of the common stock (\$10 per share) multiplied by the 2,000 shares distributed, and credit additional paid-in capital for the excess of the market value (\$16 per share) over the par value (\$10 per share) multiplied by the 2,000 shares distributed. Total stockholders' equity does not change, but, because this is considered a small stock dividend, recognition has been made of a capitalization of retained earnings equivalent to the market value of the additional shares resulting from the stock dividend.

c. Brady should account for the cash dividend on December 20, 1984, the declaration date, by debiting retained earnings and crediting cash dividends payable for \$1 per share multiplied by the number of shares outstanding. A cash dividend is a distribution to the corporation's stockholders. The liability for this distribution is incurred on the declaration date, and it is a current liability because it is payable within one year (January 10, 1985). The effect of the cash dividend on Brady's balance sheet at December 31, 1984, is an increase in current liabilities and a decrease in retained earnings.

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INDEX — QUESTIONS

HOW TO USE THIS INDEX: This index presents examination question number references for the four sections of the CPA examination — Accounting Practice Parts I and II, Auditing, Business Law, and Accounting Theory. Each examination section has been organized according to its content specification outline, with questions indexed according to the areas and groups tested.

The question references listed in the right hand column are designated as follows: The question numbers are followed by a dash and the page number in this book. The letter M following question numbers indicates a multiple choice item. For example, the reference 17M-4 means multiple choice item number 17 on page 4; the reference 5-14 means essay or problem number 5 on page 14. Note that, in the Accounting Practice section, no distinction has been made between parts I and II.

Accounting Practice — Content Specification Outline

Accounting Practice — Content Specification Outline (cont.)

Accounting Practice — Content Specification Outline (cont.)

Auditing — Content Specification Outline

Business Law — Content Specification Outline

Accounting Theory — Content Specification Outline

Accounting Theory — Content Specification Outline (cont.)

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WAYNE R. BORKOWSKI, *St. Martin's College, Washington.*
DONNA A. DINGUS, *Ohio University — Southern Campus, Ironton.*
G. F. DOMINIAK, *Texas Christian University* (contributed through the Texas Society of CPAs — CPA Examinations Committee).
ALBERT K. FRANCISCO, *Idaho State University.*
PATRICIA A. FRISHKOFF, *Oregon State University.*
G. WILLIAM GLEZEN, *University of Arkansas.*
RITA HULL, *Virginia Commonwealth University.*
EUGENE F. MCNIFF, *Baker and McNiff, Virginia Beach.*
DAVID MINARS, *Brooklyn College.*
WILLIAM J. MORRIS, JR., *North Texas State University* (contributed through the Texas Society of CPAs — CPA Examinations Committee).
MARY ELLEN PHILLIPS, *Oregon State University.*
DAVID A. SCHERBARTH, *University of West Florida.*

FUTURE CPA EXAMINATION DATES

1986 — May 7, 8, 9
November 5, 6, 7
1987 — May 6, 7, 8
November 4, 5, 6
1988 — May 4, 5, 6
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1989 — May 3, 4, 5
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1990 — May 2, 3, 4
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1991 — May 8, 9, 10
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1994 — May 4, 5, 6
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1995 — May 3, 4, 5
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Candidates can facilitate their study of past CPA examination questions by using the index on pages 79 through 85 in conjunction with the five-year index contained in *Selected Questions and Unofficial Answers Indexed to Content Specification Outlines.*

Information about *Selected Questions and Unofficial Answers Indexed to Content Specification Outlines* and an order form are printed on the following page.

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